STATE OF TENNESSEE
BEFORE THE TENNESSEE PUBLIC UTILITY COMMISSION

24-00044

IN RE:

LIMESTONE WATER UTILITY OPERATING COMPANY

DIRECT TESTIMONY

OF

MIKE DUNCAN

ON

DESCRIPTION OF OPERATIONS, RATE CASE OVERVIEW, RATE CONSOLIDATION, COMPLIANCE FUNCTIONS, ACQUISITION ADJUSTMENT RECOVERY, ALTERNATIVE RATEMAKING MECHANISMS.

SPONSORING PETITIONER'S EXHIBITS:

Petition's Exhibit MD-1: Corporate Organization Chart
Petitioner's Exhibit MD-2: Arizona Policy on Acquisition Adjustment Recovery
Petitioner's Exhibit MD-3: Florida Policy on Acquisition Adjustment Recovery
Petitioner's Exhibit MD-4: Texas Policy on Acquisition Adjustment Recovery

FILED: July 16, 2024

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I. INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Mike Duncan. My business address is 1630 Des Peres Road, Suite 140, St. Louis Missouri, 63131.

Q. WHAT IS YOUR POSITION WITH LIMESTONE WATER UTILITY OPERATING COMPANY?

A. I am Vice President of CSWR, LLC ("CSWR"), the affiliated company providing managerial and operational services to Limestone Water Utility Operating Company, LLC, ("Limestone Water" or "Company"). At CSWR, my responsibilities include project management for the acquisition, development, and rate stabilization of CSWR-affiliated utilities. These duties include project portfolio management and capital planning for all CSWR-affiliated facilities. In addition, I am responsible for engaging and overseeing engineering services, including capital planning for operating affiliates like Limestone Water. Finally, I am responsible for the supervision of the compliance team overseeing the operating affiliates like Limestone Water. At the present time, I oversee such activities for affiliated companies providing water or wastewater utility services to more than 167,000 connections in Arizona, Arkansas, Florida, Kentucky, Louisiana, Tennessee, Missouri, North Carolina, South Carolina, Tennessee, and Texas.

Q. PLEASE DESCRIBE YOUR EDUCATIONAL AND PROFESSIONAL EXPERIENCE.

A. I received a Bachelor of Arts degree with honors from Washington University in St. Louis with a major in Religious Studies. The first eleven years of my career were spent as an administrator and later director at a non-profit organization in St. Louis, Missouri. In my final position, I oversaw accounting, finance, human resources, IT and communications for the organization. During my employment at the non-profit, I received a Master's Degree in Business Administration with honors from Olin School of Business at Washington University in St. Louis. Prior to beginning with CSWR, I spent two years as Director of Operations with Auto Tire & Parts Napa, a partner-owned chain of auto parts stores, overseeing projects related to distribution, logistics, IT, and general management.

Q. WHAT IS THE RELATIONSHIP OF LIMESTONE WATER TO CSWR?

A. Limestone Water is an affiliate of CSWR. A corporate organization chart illustrating the relationship is attached hereto as **Petitioner's Exhibit MD-1**. For the companies shown on that exhibit, Central States Water Resources, Inc. serves as Manager. Later in my testimony, I will discuss the role CSWR currently plays for its affiliated utility operating companies, including Limestone Water.

Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY IN SUPPORT OF THIS RATE CASE?

A. The purpose of my direct testimony is six-fold. ***First***, I will briefly describe Limestone Water's operations in Tennessee. ***Second***, I will describe, generally, Limestone Water's request for an increase in rates, why that increase is necessary, and why the Commission should grant that request. In this section, I will also introduce the various Limestone Water witnesses and the subject matter on which they will testify. ***Third***, I will discuss Limestone Water's request to consolidate rates across all its Tennessee operations and how

consolidation will help mitigate rates and encourage the acquisition of small, distressed systems. ***Fourth***, I will discuss the functioning of the CSWR Compliance team, the improvements made as a result of that team's efforts, and the benefits that it provides to Tennessee ratepayers. ***Fifth***, I will discuss the policy rationale for the recovery of an acquisition adjustment as it applies to small water and wastewater systems. Then, in conjunction with the direct testimony of Limestone Water witnesses Mr. Brent Thies, Mr. Aaron Silas, Mr. Jake Freeman and Mr. Todd Thomas, I will address some of the factors considered by the Commission in its consideration of the recovery of acquisition adjustments. ***Sixth***, I will briefly discuss Limestone Water's request to establish parameters and methodologies to enable Limestone Water to petition for an Annual Rate Mechanism ("ARM"), as provided for under Tenn. Code Ann. § 65-5-103(d)(6).

Q. ARE YOU SPONSORING ANY EXHIBITS?

A. Yes, as introduced later in this testimony I am sponsoring the following exhibits:

Petitioner's Exhibit MD-1: Corporate Organization Chart
Petitioner's Exhibit MD-2: Arizona Policy on Acquisition Adjustment Recovery
Petitioner's Exhibit MD-3: Florida Policy on Acquisition Adjustment Recovery
Petitioner's Exhibit MD-4: Texas Policy on Acquisition Adjustment Recovery

Q. WERE THESE EXHIBITS EITHER PREPARED BY YOU OR PREPARED UNDER YOUR SUPERVISION?

A. Yes.

II. DESCRIPTION OF LIMESTONE WATER'S OPERATIONS

Q. PLEASE DESCRIBE LIMESTONE WATER'S CURRENT OPERATIONS IN TENNESSEE.

A. Limestone Water currently provides water service to approximately 573 water connections being served by 2 water systems[1] and wastewater service to approximately 1,914 sewer connections being served by 8 wastewater systems.[2] All told, Limestone Water currently operates in the following Tennessee counties: Hardin, Williamson, Marshall, Hardeman, and Campbell. A map showing the Limestone Water's geographically dispersed Tennessee service areas is attached as **Petitioner's Exhibit TT-1** to the direct testimony of Limestone Water Witness Senior Vice President Todd Thomas. As of the date of this testimony, Limestone Water has invested more than $9.5 million in Tennessee to acquire, upgrade, and improve the water and wastewater systems it currently operates.[3]

Q. DOES LIMESTONE WATER PROPOSE TO ACQUIRE ADDITIONAL SYSTEMS IN TENNESSEE?

A. Yes. Currently, Limestone Water has four (4) acquisition applications pending before the Commission. Through these four acquisitions, Limestone Water seeks to acquire five additional Tennessee water and wastewater systems.[4] Upon approval, these acquisitions will expand Limestone Water's footprint to Rhea, Cumberland, Putnam, Decatur, and Union counties and provide further long-term stability and ongoing benefits and improvements to Tennessee's overall water and wastewater infrastructure

[1] Aqua Utilities and Candlewood Lakes.
[2] Aqua Utilities, Cartwright Creek – Grassland, Cartwright Creek – Hideaway, Cartwright Creek – Arrington Retreat, Cartwright Creek – Hardeman Springs, Chapel Woods, Shiloh Falls, and DSH – Lakeside Estates.
[3] The amount invested increases dramatically to $12.1 million when one includes the recognition of $2.6 million of past operating losses.
[4] Integrated Resource Management, Inc. d/b/a IRM Utility Inc. (Docket No. 23-00037); Newport Resort Water System (Docket No. 24-00034); Cumberland Basin Wastewater Systems, LLC (Docket No. 23-00077); and Sunset Cove Condominium HOA (Docket No. 23-00070). The Cumberland Basin acquisition will result in the acquisition of two wastewater systems: Genesis Village Estates and The Bluffs at Cumberland Cove.

Q. PLEASE DESCRIBE THE GENERAL NATURE AND CONDITION OF THE WATER AND WASTEWATER SYSTEMS PREVIOUSLY ACQUIRED BY LIMESTONE WATER.

A. In his testimony, Mr. Thomas provides a listing of the Limestone Water systems and provides a detailed description of condition of each system. In addition, Mr. Freeman also provides information on the challenges faced by some of these systems and the capital improvements that will need to be made to address those issues. That said, however, I can provide a general description of the water and wastewater systems, including providing some highlighted examples.

As reflected in the testimony of Mr. Thomas and Mr. Freeman, several of the systems acquired by Limestone Water suffered from operational shortcomings and deficiencies. In many cases, these deficiencies resulted in a failure to meet environmental permit limits. For example, modifications were made by the Company to the Aqua Utilities wastewater system to return proper functioning to the aeration and spray field and to restore capacity at 41 lift stations.

Problems and challenges were much more extensive at the Grassland facility. There, unfortunately, a 50-year-old system was allowed to deteriorate to the point that the system must now be completely replaced. As Mr. Thomas describes, rusting and deterioration of the tanks and aeration facilities reduced treatment efficacy. As a result, the plant has struggled to meet permitted limits for biochemical oxygen demand, ammonia, total nitrogen, dissolved oxygen, suspended solids, total residual chlorine, and *E. coli*.

While a new treatment facility is being designed and permitted, Limestone Water has taken several steps to mitigate problems and achieve the highest level of performance

from that system. For instance, as a short-term repair, the Company has repaired aeration equipment including the replacement of rusted steel air headers, drop pipes and diffusers, to ensure the addition of oxygen to the aeration tank. Additionally, the system was plagued by impacted solids in the clarifier, chlorine contact chamber, filtration system tanks, lift stations, and the sludge return line. In such cases, impacted solids were pumped from these various system components, and service was restored. Ultimately, while the system must be replaced to meet total loading limits for the increased flow that the plant is receiving, Limestone Water made short-term upgrades to allow the system to operate at its peak efficiency and within requirements for effluent concentration limits.

Finally, as described further in Mr. Thomas' testimony, while the Hideaway Hills included a recent developer-constructed expansion, much of that expansion was overly sophisticated, oversized relative to the flow generated, poorly configured, and lacked automation that was included in original design plans. As a result, Limestone Water had to make significant revisions to make that developer-constructed expansion operate properly.

Q. CAN YOU COMMENT ON THE IMPORTANCE OF COMPLIANCE AND SYSTEM MAINTENANCE AND INVESTMENT?

A. Yes. Generally, most people take the provision and availability of water and wastewater services for granted. The public at large does not give much thought to the safety of water and wastewater, largely because the reliability of water and wastewater is generally high in most parts of the country. The safety and reliability of water and wastewater is due in part to appropriate system maintenance and infrastructure investment. If a system is not well-maintained and falls into a state of disrepair and deterioration, the safety and

reliability of that system will eventually become increasingly less safe and less reliability, which can have severe and detrimental impacts on the health and well-being of customers.

Q. HAVE CUSTOMERS EXPERIENCED TANGIBLE BENEFITS FROM LIMESTONE WATER'S ACQUISITION OF THESE SYSTEMS?

A. Absolutely. As is evidenced in the Petition and accompany supporting testimony and documentation, Limestone Water has brought a level of technical, managerial and financial expertise to these systems that was not present with past ownership. As a result, current assets are operating at an optimal level. Therefore, customers are receiving improved water and wastewater services.

Additionally, as a result of the improved operation of wastewater treatment facilities, the discharge into the Tennessee environment has improved immensely. Moreover, where facilities need to be replaced (i.e., Grassland) or expanded (i.e., Shiloh Falls and Candlewood Lakes), Limestone Water has brought a level of financial and engineering expertise to these systems such that capital improvements can be made by the Company rather than customer financed through a financial security escrow account, if at all. As a result, it is clear that for the systems that it has acquired to date, customers have realized tangible benefits from Limestone Water's acquisitions.

Finally, while Limestone Water has brought professional services to its customers, it did so by leveraging the economies of scale inherent from Limestone Water's existence as part of a larger 11-state CSWR entity. A prime example of this is discussed in Mr. Silas' testimony. It would be impossible for a small water / wastewater system to provide 24/7 customer service to a limited number of customers. That said, however, Limestone Water is able to leverage its existence as one of 11 CSWR-affiliated utility companies, providing

service to over 167,000 customers, to allow it to provide 24/7 customer service. The same economies of scale that apply to the customer service function also allows Limestone Water to economically provide other professional services including finance, accounting, billing, human resources, engineering, IT, regulatory, corporate communications, legal, and overall managerial support. Certainly, given the small size of the individual systems acquired by Limestone Water, and the associated small number of customers served by each system, it would have been virtually impossible for the previous owners to provide a similar level of utility services and investments as those currently being provided and made by the Company to these small customer bases.

III. RATE CASE OVERVIEW

Q. HOW DID LIMESTONE WATER CALCULATE THE LEVEL OF INCREASE IN THIS CASE?

A. Limestone Water calculated its proposed rates based upon an April 30, 2024 historical test year. The Company believes that the historical test year is indicative of going forward operations and represents a proper matching of rate base, costs and revenues. A more detailed discussion of the test year is contained in the testimony of Mr. Thies.

Q. PLEASE SUMMARIZE THE RATE INCREASE THAT LIMESTONE WATER IS PROPOSING IN THIS CASE.

A. Limestone Water is asking the Commission to approve a total annual revenue requirement for the water operations of $649,455. Recognizing that adjusted current revenues are $198,894, this represents an annual increase of $450,561. Similarly, for its sewer operations, Limestone Water is seeking a total annual revenue requirement of $2,410,952. Current adjusted revenues are $1,187,678. Therefore, Limestone Water is seeking an

annual increase for sewer operations of $1,223,275.[5] The specific elements of the revenue requirement, and how the revenue requirement was derived, is discussed in detail in the direct testimony of Brent Thies.

Q. DO YOU BELIEVE THAT THE PROPOSED RATE INCREASES ARE REASONABLE?

Yes. As mentioned above, and as set forth in the direct testimony of Limestone Water witnesses, the systems that Limestone Water has acquired and hopes to acquire are typically poorly managed, and almost all the owners of those systems did not have the technical, managerial, and financial ability to make the necessary capital investments to ensure regulatory compliance and provide safe, efficient, and reliable service to customers. Moreover, most of those owners also failed to timely seek rate increases necessary to enable the previous owners to properly operate and maintain the systems. As a result, the rates that Limestone Water adopted when it acquired the systems – *i.e.*, rates in effect at closing – typically were insufficient to cover the operating costs for operations – that were woefully unprofessional and inadequate – and also failed to provide an opportunity for a fair rate of return. For instance, the Aqua Utilities systems have not had a rate increase in 18 years.[6]

Limestone Water's acquisition changed all that. ***First***, as described in Mr. Thomas' testimony, professional, experienced, and licensed professionals now oversee the operation and maintenance of these systems. And Limestone Water has made plant investments necessary to significantly improve service and set systems on a path that will ensure they

[5] See, Petitioner's Exhibit BT-1.1 and 1.2.
[6] Similarly, the Shiloh Falls system has not had a rate increase since 2007 and the DSH – Lakeside Estates system has not had a rate increase since 2011.

will fully comply with federal, state, and local laws and regulations. ***Second***, as Mr. Silas testifies, Limestone Water also has greatly upgraded and improved customer service and corporate communications so that customers are informed of the on-going issues being remediated in each community. ***Third***, as indicated in Mr. Freeman's testimony, Limestone Water has brought a level of engineering expertise to these systems that allows it to improve system performance while minimizing the level of capital upgrades. Rather than simply replace all systems, the Company has instead sought to modify current system assets to attain optimal performance. ***Fourth***, as I indicate later in my testimony, Limestone Water has deployed a knowledgeable compliance team to these systems such that the systems achieve maximum compliance with environmental and regulatory standards.

However, the costs to upgrade and improve the systems and operate them in a manner that ensures customers have safe and reliable service that complies with all applicable health, safety, and environmental regulations have significantly increased operating costs. To address those costs, Limestone Water is forced to seek an increase in rates, which for some of the systems have not changed for many years.

This rate filing is designed to achieve two (2) primary objectives. First, Limestone Water wants to increase rates to a level that allows it to not only provide services that properly serves and protects the public interests, but also permits the Company to recover reasonable operating costs as well as an opportunity for a fair return on the investments it makes to serve customers. Second, Limestone Water seeks to unify the terms of service and consolidate rates statewide in a manner that streamlines and simplifies the Company's tariff and supports the economies of scale and related benefits that Limestone Water offers.

Q. WHAT WITNESSES ARE PROVIDING DIRECT TESTIMONY IN SUPPORT OF YOUR RATE INCREASE REQUEST AND WHAT SUBJECTS WILL EACH OF THOSE WITNESSES ADDRESS?

A. In addition to myself, seven other witnesses will provide direct testimony in support of the proposed rate increase. Those witnesses and the subjects they will cover in their respective testimonies are as follows:

- Todd Thomas - Discussion of the process for qualifying and selecting outside Operations and Maintenance contractors; improvements made through Limestone Water's operational team, and recovery of acquisition adjustments.
- Jacob Freeman – Discussion of systems to be acquired, the required system upgrades and capital improvements planned by the engineering department associated with the Grassland wastewater treatment plant replacement, Shiloh Falls spray field expansion, and the additional of a redundant well at Candlewood Lakes, and the recovery of acquisition adjustments.
- Brent Thies – Development of the proposed test year, discussion of how the revenue requirement was developed, rate base including additions made through the attrition period, recovery of acquisition adjustments and pre-acquisition legal and engineering costs, depreciation expense, income taxes, Cartwright Creek contributed plant, termination of financial security escrow accounts.
- Clare Donovan: Accounting Controls and Budget Procedures, annualization of operating expenses and test period revenues.
- Aaron Silas – Corporate communications initiatives, customer service functions, acquisition adjustment recovery, rate design, and proposed tariffs.

- Dylan D'Ascendis – Capital structure, cost of debt, return on equity, and overall rate of return.

Q. WHY ARE THE RATE INCREASES THAT LIMESTONE WATER SEEKS IN THIS CASE NECESSARY?

A. There is no question that, from either an operating expense or a capital investment standpoint, it costs more to professionally operate water and wastewater systems in a manner that complies with applicable law and regulatory requirements than it costs to operate failing, non-compliant systems. Several of the systems Limestone Water acquired had significant long-term compliance and operational issues, and this rate request reflects the increased capital and operating costs required to address those deficiencies.

For instance, and as will be outlined in detail in the direct testimony of Limestone Water witness Thomas, many wastewater systems did not have operational mechanical components. For instance, many systems lacked operational aeration and disinfection equipment or redundant pumping at lift stations. There is a financial impact associated with the capital associated with replacing these failed components. What is often forgotten, however, is that the replacement of these failed components also causes an immediate increase in operations and maintenance costs. That is to say, a failed blower does not use any electricity. Therefore, once a blower is replaced and begins to operate, power costs necessarily increase. Still again, a disinfection system that does not add disinfection to the wastewater discharge is incurring very little chemical cost. When the disinfection system is replaced and operated properly, chemical costs will immediately increase. For this reason, and as I have indicated, it costs more to professionally operate a system, both from

a capital investment and operating cost standpoint, than it does to operate a failing, non-compliance system.[7]

Therefore, this proposed rate increase seeks not only recovery of the increased operating expenses for these systems, but also a fair return on the value of the investments made to the systems as well as the value of the assets Limestone Water acquired from the systems' previous owners.

Finally, as I mentioned earlier, most of the systems have not sought rate increases in years or even decades. As a result, the rates currently in effect, and which Limestone Water adopted upon acquisition, do not come close to reflecting current operating and compliance costs, including recent inflation-driven cost increases.[8] Consequently, the rates proposed in this case represent a significant percentage increase over current rates because current rates are well below what they would have been had previous owners exercised regulatory diligence in terms of critical repairs, capital investment, professional operations, and providing complaint customer service which would have regularly raised rates to levels required to provide safe and reliable service so customers.

[7] Excellent examples of this are found in Mr. Thomas' testimony in which he discusses the Aqua Utilities wastewater system. There, based upon prior satellite photos, it was shown that prior ownership rarely operated the aeration system for the lagoon. As a result, once Limestone Water began operating the permitted aeration system, power expense necessarily increased. Similarly, prior ownership at that wastewater system the effluent pumping and spray field system were infrequently utilized under prior ownership. As a result, sludge was simply allowed to accumulate in the lift station. Once acquired, Limestone Water not only pumped out the accumulated sludge, it also began operating the spray field. For this reason, electricity expense increased as a result of the utilization of the effluent pumping.

[8] The failure of small water and wastewater companies to ask for rate increases appears to be ubiquitous to all states. In a 1992 report, the National Regulatory Research Institute noted: "[O]ften times the smaller companies fail to ask the Commission for sufficient rate increases or do not ask at all because of the time and complexity, either real or perceived, involved in a rate case filing; the small plants may be older, less efficient, and insufficiently maintained; management may not be skilled in properly running a water and sewer utility; and the smaller customer base means economies of scale are not at the same level as the larger companies. Also, it cannot be overlooked that the accuracy of the bookkeeping of smaller companies is often in question due to poor recordkeeping, uncertain cost allocation between personal and business expenses, and improper accounting procedures." *Viability Policies and Assessment Methods for Small Water Utilities*, National Regulatory Research Institute, June 1992, at pages 3-4.

In order to maintain the provision of safe and reliable water and wastewater services throughout the State of Tennessee, at some point in time the condition and long-term sustainability of small systems across the state must be sufficiently and appropriately addressed. Rate reviews and rate increases are and have long been part of the mechanism for addressing satisfactory compliance and proper investments.

IV. RATE CONSOLIDATION

Q. HOW DOES LIMESTONE WATER PLAN TO MITIGATE THE EFFECT ON CUSTOMERS OF THE RATE INCREASES THAT IT SEEKS IN THIS CASE?

A. As mentioned above, it would be cost prohibitive for a small water / wastewater system to provide the professional services that customers should expect from their utilities. Limestone Water is able to provide these services by leveraging the economies of scale that have been created across its 11-state footprint. Even then, however, it would still be cost prohibitive to provide these services to many small systems if rates are established on a system-by-system basis. For example, if wastewater rates were established on a system basis for Aqua Utilities, the monthly rates would be $149.82 as opposed to $83.84.[9]

Limestone Water seeks to maximize the economies of scale inherent from its ownership of several systems to mitigate the rate increase in this case. Specifically, Limestone Water maintains that, by consolidating rates across its two water systems and across its eight wastewater systems, it can mitigate the rate increases experienced by many customers. Therefore, Limestone Water proposes to mitigate the impact of the rate

[9] Still again, in a recent CSWR-Texas rate case, the Laguna Vista / Tres wastewater system would have had a $537.55/month rate absent statewide consolidation. With consolidation, the rate for that system was mitigated to $63.28/month.

increases it requires by consolidating rates for all of its Tennessee systems.[10] Under that consolidation proposal, all Limestone Water customers would be charged the same statewide rate for water or wastewater service.

Q. WOULD YOU DESCRIBE SOME OF THE BENEFITS OF CONSOLIDATED TARIFF PRICING?

A. It has been CSWR's experience across 11 states that consolidated pricing results in several benefits. ***First***, as has been well-established in the industry, single tariff pricing helps to encourage the acquisition of small, troubled water and wastewater systems by spreading costs to a larger customer base.[11] ***Second***, the consolidation of systems into a single tariff mitigates rate impacts and promotes affordability.[12] ***Third***, while there may be different technologies utilized at different systems, all Limestone Water systems share many of the same costs of service, generally use the same third-party operations firm, and are managed to the same service quality standards.[13] ***Fourth***, the development of a single set of tariffs

[10] While I describe the policy reasons for consolidation and the benefits resulting from consolidation, Mr. Silas implements the consolidation in his proposed rate design.

[11] In support of each of these assertions regarding the benefits of consolidation, Limestone Water notes testimony from the Staff in recent Missouri Public Service Commission rate cases. ""The systems that MAWC [Missouri American Water Company] has been purchasing are small systems with mostly small, primarily residential customer bases. In order to keep these small systems in proper working order so that they can continue to provide safe, adequate, and reliable service to their customers, investment is needed or will need to be made in the future. When improvements need to be made, the higher cost of upgrades must be spread over the smaller customer base, which may cause rates to increase dramatically. The dramatic increases may result in rate shock to consumers. . . In Staff's opinion, moving away from a strict DSP [District Specific Pricing] rate design philosophy will encourage not only MAWC, but other water and sewer utilities, to invest in Missouri." (Missouri Public Service Commission Case No. WR-2015-0301, Busch Direct, filed January 20, 2016, pages 8 and 9).

[12] "Staff agrees that spreading out costs over a larger customer base will tend to lower rates." "Mr. Jenkins makes a good point that complying with regulations is expensive and spreading those costs over a larger customer base allows for the benefit of economies of scale to lower costs to the customers." (Missouri Public Service Commission Case No. WR-2017-0285, Busch Rebuttal, filed January 24, 2018, page 15 and 16). "The primary benefit of STP [Single Tariff Pricing] is that it spreads out costs to a larger customer base." (Missouri Public Service Commission Case No. WR-2015-0301, Busch Direct, filed January 20, 2016, page 6).

[13] "The consistency in costs to serve customers between districts is attributable to the fact that most of the costs of providing service to Missouri-American's customers are very similar, if not the same, from district to district because a portion of Missouri-American's statewide costs are allocated to the various districts. So, for example, Missouri-American's costs of capital will be the same for each of the districts. When Missouri-American buys pipe, meters,

provides for a heightened level of regulatory, administrative, and billing efficiency. Specifically, Limestone Water, as well as the Commission, won't have to maintain familiarity with a multitude of rules and rates which should lower customer costs.[14] ***Fifth***, since all systems will eventually require large capital investments over the next number of years, any perceived inequities associated with system subsidization will be short-lived and will eventually balance out.[15] ***Sixth***, since consolidated tariffs provide a more simplified approach to rates and rules, I believe that it is more consumer friendly than dozens of different rate sheets.

Q. HAVE CONSOLIDATED RATES BEEN RECOGNIZED AS A SOLUTION TO THE PROBLEM OF SMALL, NON-VIABLE WATER AND WASTEWATER SYSTEMS?

A. Yes. For years it has been recognized that single tariff pricing and the consolidation of rates encourages the consolidation of small water and wastewater systems into larger utilities. For instance, in a 2008 report, the National Regulatory Research Institute stated:

> Single tariff pricing is another way to encourage mergers. Enabling a uniform rate structure or consolidated rates for systems owned by the same entity may encourage a corporate utility to grow its business by acquiring – whether contiguous or interconnected or not – other systems. With consolidated pricing, customers pay the same price even though their individual system may have unique operating characteristics and needs.

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and other supplies, the cost of those supplies will be the same in all districts. Similarly, management salaries for Missouri-American's executives will be allocated equally to customers in each of the districts." (Missouri Public Service Commission Case No. WR-2015-0301, Report and Order, at page 12).

[14] "The reason for the difficulty in developing rates on a district-specific basis is the need to allocate corporate costs to each separate service territory. Corporate costs are a substantial portion of the cost of service for MAWC. Trying to determine the most equitable manner to allocate those costs to each service territory (especially the very small service territories) is difficult when attempting to determine the true cost of service to those service territories. Combining these service territories in the manner as Staff has in this proceeding alleviates some of the need for precision. (Missouri Public Service Commission Case No. WR-2015-0301, Busch Direct, filed January 20, 2016, page 7). Consolidation "may benefit the customers through reduced rate case expense, as is it is likely that the Company will not have to allocate as many resources to future rate cases." (*Id.*).

[15] "All water systems will eventually require large capital investments. If the cost of making those investments is spread among consolidated districts, in the long term any perceived short-term unfairness will be balanced out." (Missouri Public Service Commission Case No. WR-2015-0301, Report and Order, issued May 26, 2016, at page 16).

> Single tariff pricing makes it easier to share costs among larger numbers of customers.[16]

Q. WILL CONSOLIDATED RATES REQUIRE CUSTOMERS SERVED BY "BETTER" SYSTEMS TO SUPPORT THE COST OF IMPROVEMENTS LIMESTONE WATER IS MAKING TO SOME OF ITS WORST SYSTEMS?

A. While this may appear to be true in the short run, it isn't true if you take a longer-term view. In each of the communities Limestone Water serves all of the distribution and treatment systems will eventually require major repairs and replacements. Some of those systems require more urgent investments that require upgrades and improvements today. However, over time all the systems that Limestone Water acquires in Tennessee will require those same or similar investments. So, whatever short-term support may flow between systems that are in differing states of repair and compliance initially, that situation will inevitably reverse over time.

I also note that average cost pricing and state-wide rates are the rule rather than the exception in utility pricing. For example, although it may cost an electric or gas utility much more to serve some individual customers than it does to serve others, electric and gas utilities have for decades had uniform rates for all customers within each rate class.

Limestone Water also believes consolidated rates reflect the common benefits all of its Tennessee customers will receive from being served by Limestone Water, services that are provided more cost-effectively by consolidating systems to realize economies of scale, rather than system-specific rates, which would, in effect, punish customers of the

[16] *Small Water Systems: Challenges and Recommendations*, National Regulatory Research Institute ("NRRI"), February 7, 2008 (citing to *Joint Report of the US EPA and NARUC, Consolidated Water Rates: Issues and Practices in Single Tariff Pricing*, September 1999).

currently most challenged systems for necessary investments each community will certainly require in the future.

Finally, consolidated rates have the effect of providing more gradual rate increases as compared to the huge rate increases that some systems may see under system-specific rates. For instance, a treatment plant upgrade for a system serving 25 connections would result in a huge rate increase under a system-specific rate structure. In contrast, however, the rate increase is tempered if such costs are allowed to be spread across all of the Limestone Water connections.

Q. HAVE RATES BEEN CONSOLIDATED TO ANY DEGREE FOR LIMESTONE WATER SYSTEMS ALREADY?

A. Yes. The Cartwright Creek system consists of four wastewater systems. The rates for three of those systems (Arrington Retreat, Hideaway, and Hardeman Springs) were previously consolidated at a flat monthly rate of $55.25.

Q. HAVE CONSOLIDATED RATES BEEN IMPLEMENTED FOR OTHER CSWR AFFILIATES?

A. Yes. CSWR affiliates operating in Louisiana, Mississippi, Texas, Missouri and Kentucky have all seen water and wastewater systems consolidated. The following holding from the neighboring state of Kentucky is indicative of the logic utilized by these states in approving the consolidation of systems.

> The Commission supports the principle that utility rates should be cost based, and that in most circumstances each class of utility ratepayers should pay the costs which the utility incurs to provide that class with utility service. The majority of Bluegrass Water's customers are in the residential class. A separate rate for each geographically distinct merged system of Bluegrass Water would create unreasonable and undue hardship to individuals in some areas served by Bluegrass Water.[17]

[17] In re: Bluegrass Water Utility Operating Company, Case No. 2022-00432, issued February 14, 2024, at page 96.

Moreover, while CSWR has yet to file an Arizona rate case, the Arizona Corporation has issued a definitive policy statement encouraging the consolidation of water and wastewater systems.

> The private water utility industry in Arizona is highly fragmented and problematic. This Commission has seen first-hand the extent to which small water utilities sometimes struggle both financially and operationally. The struggles of these companies can have direct impacts on the service they provide to their customers. Consolidating the small systems through purchases by larger systems has long been proposed as a solution to the problems associated with small systems and this Commission has endorsed consolidation through purchase at various times over the past decades. We recognize that consolidation can be an effective method of solving problems associated with small systems and propose several policies here to encourage consolidation directly.
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> Policy Regarding Rate Consolidation for Small Jointly Owned Water Utilities: Small Utilities in rural areas have largely been treated as stand-alone entities by the Commission for ratemaking purposes. Traditionally, a strict interpretation of the "cost user pays" principle has inhibited small water systems that do not share common facilities from consolidating rate designs. ***As a general policy, the Commission believes that the practical benefits from allowing rate consolidation involving small water and wastewater utilities far outweigh the benefits of a strict adherence to this theoretical principle***.[18]

V. COMPLIANCE FUNCTIONS

Q. WOULD YOU DESCRIBE THE CSWR COMPLIANCE TEAM?

A. Yes. The Environmental, Health and Safety ("EHS") team works with the state manager, O&M contractor and CSWR engineers to maintain compliance with the Clean Water Act, Safe Drinking Water Act, and Occupational Safety and Health Administration regulatory requirements. In this role the EHS focuses primarily on 3 important functions:

[18] Docket No. W-00000C-16-0151, Decision No. 75626, issued June 25, 2016, at pages 1 and 18 (emphasis added).

1) Monitoring and completion of system compliance tasks for each system operated by Limestone Water including but not limited to issuing Consumer Confidence Reports ("CCRs") for water systems, backflow device program management, and lead service line inventories.

2) Responses to Environmental Agency correspondence that arise from agency inspection, complaints to agencies, and violation of numeric standards. In this role, the EHS team ensures that corrective actions are completed and accurately reported to the relevant agency.

3) Effectuation of state and local operating permit transfers and renewals.

4) Facility inspections of any system acquisitions prior to closing and at least once a year thereafter to ensure compliance with regulations governing facility operations and maintenance.

Q. DO YOU HAVE A ROLE WITH REGARD TO THE EHS TEAM?

A. Yes. I supervise the EHS team.

Q. HOW DO YOU THINK THE EHS TEAM AND ITS WORK SUPPORT THIS RATE CASE?

A. As will be discussed, the Limestone Water EHS team provides immediate benefits to the customers of the small systems acquired by the Company. Specifically, the EHS team ensures that all samples are taken consistent with operating permits and state environmental regulations. Moreover, through its annual inspections, the EHS visually

ensures that the systems are operated in a manner that complies with state and federal requirements. Finally, the EHS team ensures that necessary reports, including consumer confidence reports, are prepared and disseminated as required. In many cases, small water and wastewater systems are not aware of such requirements or do not have the professionally trained staff to meet such requirements. As such, by applying the talents of such a team to the systems that are acquired, Limestone Water is capable of providing immediate benefits to customers.

Q. DO YOU HAVE ANY RESULTS FROM THE ACTIONS OF THE EHS TEAM IN TENNESSEE?

A. Consistent with the third function described above (facility inspections), the EHS team has completed, for the 2024 calendar year, its inspection at 6 of the 10 systems owned and operated by Limestone Water. Further, thus far in 2024, the EHS has ensured 100% sample compliance at all of the Limestone Water systems. This has involved 592 wastewater samples and 18 drinking water samples.

Q. HAS THE EXISTENCE OF THE CSWR EHS TEAM BROUGHT BENEFITS TO LIMESTONE WATER CUSTOMERS?

A. Absolutely. As mentioned, most small water and wastewater systems do not have the technical expertise to ensure compliance with the myriad governmental regulatory requirements.

Q. DO YOU HAVE ANY PHOTOS THAT SHOW THE IMPROVEMENTS BROUGHT BY THE CSWR EHS TEAM TO ENSURE REGULATORY COMPLIANCE?

A. Yes. While some of these issues reflected in these photos may seem minor to non-water and wastewater compliance professionals, they show the efforts that the CSWR EHS take, and the repairs that are then made, to ensure compliance with all state and federal regulatory requirements.

The following photos show conditions at the *Aqua* facilities that failed to comply with OSHA regulations as well as requirements for safe and adequate water and wastewater service.

Missing safety labels, Obsolete, unused water filter (left), Safety labels applied; Obsolete equipment removed (right).

System lacking redundant booster pump to maintain minimum system pressure (left). redundant booster pump installed to maintain system pressure (right).

The following photos show compliance improvements made at the Arrington Retreat facility.

Broken (left) and repaired (right) spray field spigot.

Unguarded blower, unsafe, grassy work surface (left). Blower box repaired, all weather terrain work surface installed.

The following photos show compliance upgrades made at the Hideaway system following Limestone Water's acquisition of those assets.

Hideaway lagoon lacked berm erosion measures (left), berm erosion measures installed.

Prevalence of duckweed prevents proper treatment (left), duckweed removed, treatment restored.

Finally, the following photos from the Grassland system demonstrate some of the many compliance upgrades implemented following the acquisition by Limestone Water.

Grassland mechanical room upon acquisition (left), Grassland mechanical room after rehabilitation (right).

Package plant lacked permanent access, Operators used a temporary ladder (left), Permanent access installed (right).

Q. DO WATER AND WASTEWATER SYSTEMS FACE AN INCREASINGLY STRINGENT REGULATORY ENVIRONMENT?

A. Yes. As a result of authority granted to various state and federal agencies, small water and wastewater systems are facing an increasingly stringent and, oftentimes, complex system of environmental requirements and regulations. As an example, in recent years, the Environmental Protection Agency ("EPA") has issued regulations in recent years that necessitate sampling for PFAS (described below), and an inventory of lead and copper services lines.

Q. WHAT ARE PFAS?

A. Per and Polyfluoroalkyl Substances ("PFAS") are a very large class of synthetic organofluorine chemical compounds. These substances are used in various industrial applications, including non-stick coatings, firefighting foams, and water-repellent fabrics. PFAS is known as a forever compound in that they take so long to degrade.

Q. WHAT IS THE CONCERN WITH PFAS?

A. PFAS are a concern in that they are persistent in the environment, bioaccumulative in organisms, and they are toxic at relatively low (parts per trillion) levels. Recent studies suggest that, when ingested, PFAS may cause various types of cancer.

Q. WHY IS PFAS A PREVALENT ISSUE IN THE WATER INDUSTRY?

A. As I mentioned, PFAS chemicals are persistent in the environment. In certain areas, primarily those with heavy industry or military installations, PFAS has been found to have leached into groundwater aquifers. In April 2024, after notice and comment, the EPA set the maximum contamination level (MCL) for six contaminants (PFOA, PFOS, PFBxS, PFNA, GenX, and a mixture of four different PFAS constiuents) with the most stringent MCL set at 4.0 parts per trillion (ppt or ng/L).

Q. HOW LONG DOES THE WATER INDUSTRY HAVE TO ATTAIN COMPLIANCE WITH THE NEW PFAS LIMIT?

A. The EPA established a compliance timeline whereby initial monitoring must be completed within three years of the rule (April 2027). Within five years of the enactment of the rule (April 2029), water utilities must comply with the new PFAS MCL.

Q. HAS LIMESTONE WATER COMPLETED THIS REQUIRED TESTING IN TENNESSEE?

A. As of the filing of this testimony, Limestone Water owned two water systems in Tennessee: (1) Aqua Utilities and (2) Candlewood Lakes.[19] Aqua Utilities is a purchased water system in that it relies entirely on water purchased from the town of Savannah, Tennessee. Candlewood Lakes, on the other hand, produces its own water through a submersible pump. While Limestone Water has until April 2027 to complete this testing, the CSWR compliance team anticipates that its independent PFAS testing will be completed by the end of 2024.

Q. PLEASE DESCRIBE THE EPA REQUIREMENT TO TEST LEAD AND COPPER SERVICE LINES.

A. In 1991, the EPA published its Lead and Copper Rule ("LCR") to control lead and copper in drinking water. That rule seeks to reduce the action level of lead to 15 parts per billion and copper to 1.3 parts per million. Recognizing that lead is typically introduced into drinking water from lead service lines fittings, the rule requires public water suppliers to conduct an initial service line inventory of lead service lines. Water suppliers are then

[19] Limestone Water has a pending application to acquire the Newport Resort Water System (Case No. Docket No. 24-00034). If acquired, Limestone Water would also have to attain PFAS compliance for that system as well.

required to notify persons of known or potential lead service lines. This initial service line inventory is required to be completed by October 16, 2024.

Q. HAS LIMESTONE WATER COMPLETED ITS LEAD AND COPPER MONITORING?

A. Routine lead and copper monitoring was started earlier this year and is expected to be completed by September, in advance of the EPA's compliance deadline.

Q. ARE THERE A HOST OF OTHER ESSENTIAL COMPLIANCE AND SAFETY ISSUES IN ADDITION TO PFAS AND LCR?

A. Yes. By addressing only a subset of such issues, I do not mean to imply that these are the only two monitoring/compliance areas. Rather, I summarize these two regulations because they demonstrate the increasingly stringent nature of water / wastewater regulation, the fact that such regulations are applicable to all companies, and the difficulty that small water/wastewater companies will have in complying with such regulations. Furthermore, the stringency of water / wastewater regulation will continue to evolve as more pollutants are identified and addressed.

VI. ACQUISITION ADJUSTMENT RECOVERY

Q. WOULD YOU EXPLAIN WHAT AN ACQUISITION ADJUSTMENT IS?

A. An acquisition adjustment is the amount by which the acquisition price exceeds the net book value of a particular utility or system.

Q. WHAT IS YOUR UNDERSTANDING OF THE COMMISSION'S POLICY FOR RECOVERY OF AN ACQUISITION ADJUSTMENT?

A. Tennessee Commission Rule 1220-04-14-.04 states that "[t]he Commission may order an acquisition adjustment to be incorporated into the acquired rate base if the Commission

determines such adjustment is warranted under the circumstances and will not result in unjust or unreasonable rates and charges for the acquiring utility or for the customers."

The rule then sets forth six (6) factors to be considered by the Commission in its determination of whether to allow recovery of an acquisition adjustment. Those factors are:

(a) Cost savings or increases resulting from consolidation of the selling utility's system into the acquiring utility's operations;

(b) Improvements in public utilities services resulting from the acquisition;

(c) Remediation of public health, safety and welfare concerns of the selling utility's system resulting from the acquisition;

(d) Incentives for acquisition of a financially or operationally troubled system, which may be demonstrated by bankruptcy, receivership, financial distress, notice of violation, order of abatement, or inability to continue as a going concern of the selling utility;

(e) Amount of any assets contributed or donated to the selling utility included in the proposed acquisition transaction; and

(f) Any other measurable benefits, costs, or service changes affecting acquired and/or existing customers resulting from the acquisition.

Q. DOES LIMESTONE WATER SEEK RECOVERY OF ACQUISITION ADJUSTMENTS IN THIS CASE?

A. Yes. As more fully discussed in the testimony of Mr. Thies, the Company is seeking recovery of acquisition adjustments for five of its system acquisitions. In addition to myself, several Limestone Water witnesses (Mr. Thomas, Mr. Freeman, and Mr. Silas),

address the factors enumerated in the Commission's rule. Specifically, the following witnesses will address the following aspects of Limestone Water's acquisition adjustment recovery request:

Duncan: My testimony discusses the policy rationale for acquisition adjustment recovery, including the fact that acquisition adjustment recovery allows for state utility commissions to incentivize the acquisition of distressed water / wastewater systems and the consolidation of such systems to encourage economies of scale. Therefore, this policy overview demonstrates how the recovery of acquisition adjustments provides incentives for acquisition of a financially or operationally troubled system like Grassland. In addition, my testimony discusses improvements in public utilities services in the nature of improved compliance functioning as a result of the Limestone Water EHS team.

Silas: Testimony provides evidence demonstrating the immediate improvements in public utilities services provided by Limestone Water to customers of all acquired systems in the form of customer experience improvements including access to 24/7 customer service as well as corporate communications improvements. Such improvements are only capable through the economies of scale that come from consolidating systems into a larger company like Limestone Water's parent CSWR. Recognizing that small water / wastewater companies are incapable of maintaining a professional customer service and corporate communications staff, the acquisition by Limestone Water represents an immediate improvement in utilities services.

Thomas: Testimony provides evidence regarding cost savings or increases resulting from the consolidation of the selling utility's system into the acquiring utility's operations in the form of the minimal increase associated with Limestone Water's recent request for

proposal for professional O&M services. Specifically, Limestone Water was able to provide professional O&M services to each of the systems acquired while securing a minimal increase in O&M costs of less than 1%.

In addition, Mr. Thomas discusses the improvements in public utilities services in the form of operations. His testimony highlights the best example of this. Although Limestone Water is currently planning and seeking permits to replace the severely deteriorated Grassland wastewater treatment plant that is unable to treat current average flow of the system, it has been able to make short-term fixes to that plant that allow the plant to meet permit limits for effluent concentration consistently. This is a demonstrable improvement over previous ownership and practically evidences to the State of Tennessee the successful, customer-oriented outcomes that are possible when small, troubled or non-compliant systems receive appropriate management, maintenance and investment.

Freeman: Testimony discusses the professional engineering services that have been available as a result of these systems being integrated into the larger CSWR entity. Thus, as set forth in his testimony, small systems, like Grassland that lacked professional engineering services, can now access these services. Mr. Freeman discusses the steps that Limestone Water has taken to consider various technologies for utilization at Grassland and the rationale for the technology selected. Moreover, Mr. Freeman discusses the consideration of a spray field versus drip field at the Shiloh Falls system. Given that Cartwright Creek lacked a professional engineering staff, these services were not available to the Grassland systems. As a result, the system was simply allowed to continue to deteriorate. Therefore, the acquisition by Limestone Water, and the integration into the

larger CSWR footprint has brought immediate improvements in utilities services to Tennessee customers.

Thies: Testimony discusses the financial aspects of acquisition adjustment recovery including the impact of acquisition recovery of rates relative to rates absent the acquisition adjustment recovery.

Q. DO YOU BELIEVE THAT THE RECOVERY OF AN ACQUISITION ADJUSTMENT ASSOCIATED WITH THE ACQUISITION OF A SMALL WATER / WASTEWATER SYSTEM REPRESENTS SOUND REGULATORY POLICY?

A. Yes. I believe that the regulatory challenges associated with small water / wastewater systems justify a different approach to acquisition adjustment recovery than may be applicable for large, mature, well-established, electric, gas and water utilities. Specifically, many of the shortcomings associated with small, distressed water and wastewater systems derive from the lack of economies of scale and from an absence of technical, managerial and financial expertise at these small, distressed systems. Both of these challenges can be overcome by encouraging the acquisition and consolidation of these small systems into a larger, better managed water utility. Given that the owners of most small water and wastewater systems refuse to sell for simply net book value, the encouragement of consolidation must necessarily come with some understanding that an acquisition adjustment must be recognized in rates.[20]

[20] The previously referenced NRRI report, as well as that referenced in the following footnote, discuss the challenges associated with small water / wastewater utilities and various tools for the encouragement of acquisition and consolidation.

Q. HAS THIS POLICY APPROACH BEEN WIDELY RECOGNIZED?

A. Yes. For several decades, various utility regulatory groups have recognized the need to encourage the acquisition of small water systems by larger, better managed and well-capitalized water companies. Oftentimes, this has focused on the need to allow recovery of some acquisition price over and above net book value.

Q. ARE THERE SPECIFIC REPORTS THAT SUPPORT YOUR TESTIMONY HERE?

A. Yes. For instance, in October 2011, the National Regulatory Research Institute succinctly framed the problem associated with regulating small water systems.

> When dealing with small water systems, the traditional regulatory model breaks down, for three main reasons. First, the primary tool employed by regulatory commissions to induce improved performance is the ability to reward or penalize shareholders, thereby focusing the attention of utility management on particular issues of importance to regulators. Because many small water systems have part-time, often absentee management and part-time employees, and because these systems contribute little or no compensation to the owners, that tool is ineffective. Second, most regulatory processes and tools, including filing requirements, templates, and timelines, require substantial utility staff, systems, and expertise that small systems do not have. Third, at the most basic level, many small systems do not have the scale to be viable operationally and financially; therefore, no amount of regulation, incentive or otherwise, will work in the long term.[21]

The solution to the myriad problems associated with regulating small water systems is not simple. As the report indicates, "[s]ometimes the best option is to get the existing owner / operator out of the water business, using whatever means are available under the commission's authority."[22] Ultimately, the report concludes that one of the best "means" available under a commission's authority is the recovery of an acquisition adjustment. In

[21] *The Small Water Company Dilemma: Processes and Techniques for Effective Regulation*, National Regulatory Research Institute, October 2011, at page iii.
[22] *Id.* at page 16.

fact, the report concludes that, while an acquisition adjustment may lead to higher rates in the short term, rates will decline over the long term as costs are spread over a larger customer base.

> While some of the incremental costs of bringing the system up to par are in a sense absorbed by the economies of scale of the acquiring system, there may be an acquisition premium involved or the new system may need an infusion of capital. ***The commission must recognize those costs and allow them in the cost structure of the acquiring system***, or the process of improving the small, acquired system will be offset by a deterioration, albeit much smaller in scale, of the acquiring company.
>
> * * * * *
>
> The consequences to the acquiring system, when looked at in isolation, are not very appealing. ***But over the long term, as consolidation occurs, fixed costs and associated rates of the acquiring system decline on a unit basis as they are spread over a larger customer base***.
>
> * * * * *
>
> If the mandatory option is not available statutorily, commissions have a variety of incentive and penalty mechanisms to encourage acquisitions. ***Potential incentives include recognition of an acquisition premium***, as well as incentive rate of return, zone rates, or phase-ins of rate increases.[23]

Q. DID THIS REPORT SEEK TO APPLY ITS CONCLUSIONS REGARDING THE RECOVERY OF ACQUISITION ADJUSTMENTS TO LARGER UTILITIES?

A. No. The authors were very clear that their conclusions should only apply to "special cases" including small, troubled systems.

> Observation: Most commissions have an aversion to allowing recovery of an acquisition premium by the acquiring entity. Many jurisdictions will allow recovery of an acquisition premium in special cases. ***A classic special case in which premiums are allowed is the commission-mandated or commission-encouraged takeover of a troubled system***.

[23] *Id.* at page 23 (emphasis added).

> Such a premium is typically not allowed in a takeover of a well-performing system. We would call this a perverse incentive. ***Small systems present an interesting conundrum that we think mandates a revisitation***.[24]

Q. DO YOU HAVE ANY OTHER DOCUMENTS THAT ESTABLISH THE POLICY PERSPECTIVE UNDERLYING THE RECOVERY OF ACQUISITION ADJUSTMENTS?

A. Yes. The treatise *Accounting for Public Utilities* discusses the rationale underlying the historic reason for disallowing recovery of acquisition adjustments, but then also discusses the situations in which state utility commissions have deemed it appropriate to allow recovery of such adjustments. These situations in large part mirror the factors reflected in the Commission's rule.

> The reasons most commonly cited for allowing rate base treatment of acquisition adjustments are as follows:
>
> (1) when acquisitions represent an essential or desirable part of an integration of facilities program devoted to service the public better;
>
> (2) when acquisitions are clearly in the public interest, because operating efficiencies purchased offset the excess price over net original cost;. . . and
>
> (4) when acquisitions are determined to involve arm's-length bargaining.[25]

Interestingly, in support of this policy statement, the treatise directed the reader to a Tennessee case.

> In 1969, the Tennessee Public Service Commission allowed both rate base and cost of service treatment for acquisition adjustments of United Inter-Mountain Telephone Company, where the acquisitions were found to be in the best interest of the public and not for the purpose of inflating the rate base.[26]

[24] *Id.* (emphasis added).
[25] *Accounting for Public Utilities*, Hahn & Aliff, 1989, Section 4.04[2].
[26] *Id.*

Q. YOU MENTIONED EARLIER THAT OWNERS OF SMALL WATER AND WASTEWATER SYSTEMS WILL REFUSE "TO SELL FOR SIMPLY NET BOOK VALUE". WHY IS THIS?

A. In the ratemaking equation, rates typically encompass not only a return on capital invested, but also recovery of operating expenses. Operating expenses include salaries of employees that operate the systems, but also those that handle billing, regulatory, bookkeeping and management functions. As with many small water and wastewater systems, this may simply be the owner and possibly one other person. Importantly then, an owner will earn a return on the net book value of the assets. But recognizing that the net book value may be minimal due to the effect of depreciation over time, the income stream for the owner derived from an operating salary will oftentimes dwarf the income stream associated with the capital return element. Given that the owner of a small system may not have another job or income stream, that owner will not be willing to give up the operating salary for simply an acquisition price based upon net book value. Instead, the owner will demand some recognition of the last income stream associated with his / her operating salary. As such, an acquisition adjustment must be paid in order to incentivize the owner to sell the small, distressed water / wastewater system. Given this reality, it has been my experience that it is inequitable to expect an acquiring company to pay this incentive to acquire the system, but then disallow the acquisition adjustment in rates.

Q. YOU MENTIONED PREVIOUSLY THAT THE ACQUISITION AND CONSOLIDATION OF SMALL WATER AND WASTEWATER SYSTEMS TYPICALLY REQUIRES SOME ENCOURAGEMENT BY STATE REGULATORS IN THE FORM OF AN ACQUISITION ADJUSTMENT. WHAT

IS THE COMPANY'S EXPERIENCE WITH VARIOUS STATES UTILIZATION OF ACQUISITION ADJUSTMENTS?

A. As I indicated previously, CSWR now operates in 11 states. As of June 30, 2024, the Company owns and operates over 900 separate systems acquired through hundreds of various transactions. Given this, the Company is very familiar with various mechanisms used to encourage the acquisition of small water and wastewater systems. For instance, among many others, the Company directs the Commission's attention to mechanisms in Arizona, Florida, and Texas all designed to encourage the acquisition and consolidation of small systems by a larger water utility.[27]

Arizona: Allows the recovery of an acquisition adjustment ("deferred debit") associated with the acquisition of non-viable water and wastewater utilities.

On July 25, 2016, the Arizona Corporation Commission issued Decision No. 75626 in Docket No. W-00000C-16-0151 (*Arizona Corporation Commission Investigation into Potential Improvements to its Water Policies*).

> The private water utility industry in Arizona is highly fragmented and problematic. This Commission has seen first-hand the extent to which small water utilities sometimes struggle both financially and operationally. The struggles of these companies can have direct impacts on the service they provide to their customers. Consolidating the small systems through purchases by larger systems has long been proposed as a solution to the problems associated with small systems and this Commission has endorsed consolidation through purchase at various times over the past decades. We recognize that consolidation can be an effective method of solving problems associated with small systems and propose several policies here to encourage consolidation directly. . . . ***To encourage the consolidation of small water utilities, it is the policy of the Commission that acquisition premiums should be allowed for acquisitions of private water systems***.[28]

[27] Copies of these rules and policies are provided as **Petitioners Exhibit MD-2, 3, and 4**.
[28] Docket No. W-00000C-16-0151, Decision No. 75626, issued June 25, 2016, at pages 1 and 19 (emphasis added).

Florida: On August 4, 2002, the Florida Public Service Commission promulgated 25-30.0371, later amended on November 22, 2010 and June 17, 2024.

> A utility that acquires another utility may petition the Commission to establish an acquisition adjustment under subsection (3) or subsection (4) of this rule to include some or all of a a positive acquisition adjustment in the acquired utility's rate base.

Texas: On August 20, 2020, the Public Utility Commission of Texas promulgated Rule 24.41(d) regarding the recovery of positive acquisition adjustments ("When a utility acquires plant, property, or equipment for which commission approval is required under §24.239 of this title, relating to Sale, Transfer, Merger, Consolidation, Acquisition, Lease or Rental, a positive acquisition adjustment will be allowed. . . .").

Q. MIGHT THERE BE SOME DETRIMENTAL IMPACTS TO A STATE FOR FAILING TO EMBRACE THE MEANINGFUL AND CAREFUL CONSIDERATION OF ACQUISITION ADJUSTMENTS AS A MATTER OF SOUND PUBLIC POLICY?

A. Most certainly. The failure to recognize and acknowledge the appropriateness of acquisition adjustments in instances in which circumstances warrant can have serious and sometime longstanding unintended consequences. I have already noted the importance of safety and reliability in the provision of water and wastewater services and the potential consequences of system non-compliance and poor or no system maintenance. If willing buyers are discouraged from evaluating and acquiring small, troubled or failing systems, our testimony demonstrates that acquisitions are likely to slow or even stop. Naturally, acquisitions will occur in states such as Arizona, Florida and Texas in which the state utility commission has taken steps to encourage such acquisitions. The associated risks – the health and well-being of system customers – are too great to either altogether abandon even

the possibility of acquisition adjustments or to hold fast to an outdated predisposition of disfavoring acquisition adjustments.

Q. RELATIVE TO THE TENNESSEE RULE, WILL YOU ADDRESS ANY OF THE FACTORS FOR THE RECOVERY OF AN ACQUISITION ADJUSTMENT?

A. Yes. In their testimony, Mr. Thomas, Mr. Silas and Mr. Thies each discuss one or more of the factors enumerated in the Tennessee rule for consideration of an acquisition adjustment. In my testimony, I provide a portion of the Company's position regarding: (b) Improvements in public utilities services resulting from the acquisition.

Q. DO YOU BELIEVE THAT THE COMPANY HAS DEMONSTRATED IMPROVEMENTS IN PUBLIC UTILITIES SERVICES RESULTING FROM THE ACQUISITION?

A. Yes. While Mr. Thomas provides the primary discussion on this point from an operational point of view, given my supervision of the Compliance team (discussed above), I provide evidence regarding my view of Limestone Water's improvements in public utilities services. Specifically, as I mentioned previously, Limestone Water brings a level of professional management to its water and wastewater systems that is typically not available to small water and wastewater systems.

For instance, as I mentioned previously, and as reflected in the earlier pictures, Limestone Water has a dedicated compliance team that is responsible for maintaining compliance with environmental and regulatory compliance standards. Consistent with these standards, the Compliance team has ensured and monitored 592 wastewater samples and 18 drinking water samples.

In addition, the Compliance team is ensuring compliance with both the EPA PFAS and lead / copper rules. The increasingly stringent nature of environmental regulation has made it increasingly difficult for small water and wastewater systems to maintain environmental compliance. In fact, concerns associated with small water companies maintaining compliance with the lead / copper rule led to the development of a compliance guide for small entities, as required by the Small Business Regulatory Enforcement Fairness Act of 1996. In any event, these two recent regulations demonstrate the difficult small water companies have with maintaining technical, managerial and financial expertise in this industry as well as the value that a company like Limestone Water can bring to this industry niche. Given the professional compliance functions that Limestone Water has brought to small Tennessee water and wastewater systems, I certainly believe that it has brought improvements in public utilities services to these systems.

VII. ALTERNATIVE RATEMAKING MECHANISM

Q. WOULD YOU DISCUSS THE COMPANY'S REQUEST FOR AN ALTERNATIVE RATEMAKING MECHANISM?

A. Yes. Similar to the process pursued by other TPUC regulated public utilities, Limestone Water may choose to opt-into the annual rate review mechanism ("ARM") established by Tennessee Code Annotated §65-5-103(d)(6) through a petition filed outside of this docket. This statutory provision, adopted in 2013, allows a public utility to opt for an annual review of its rates. It is Limestone's plan to make a filing to seek an ARM with the Commission in the future. In this case, however, Limestone Water asks that the Commission establish the necessary rate case findings and methodologies that allow for the subsequent

implementation of such a mechanism. This request is discussed in greater context in the testimony of Mr. Thies.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.

Central States Water Resources Corporate Entity Organizational Chart

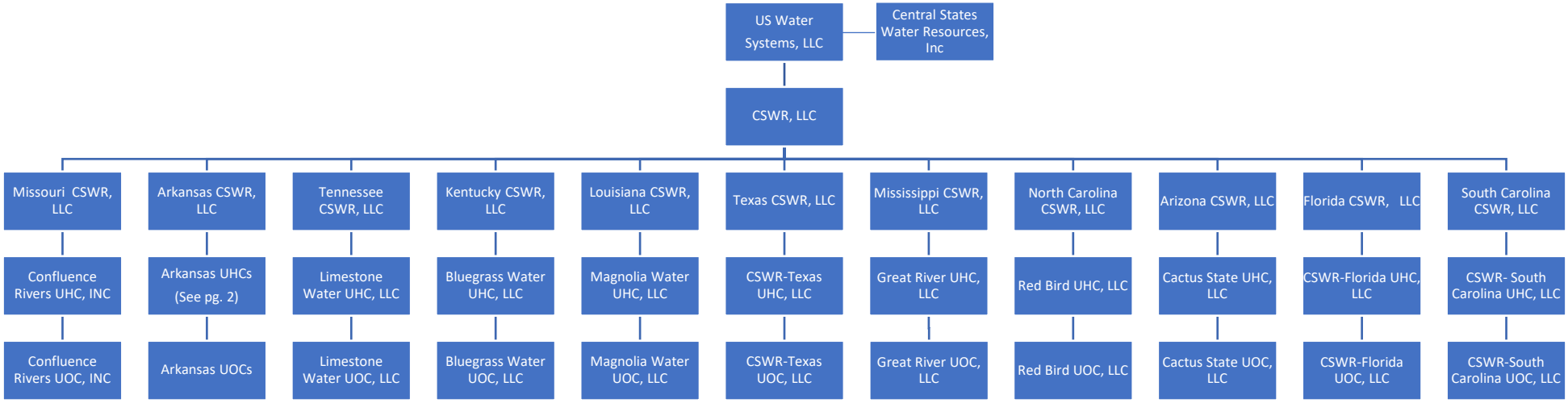

Exhibit MD-1

Arkansas CSWR Organizational Chart Detail

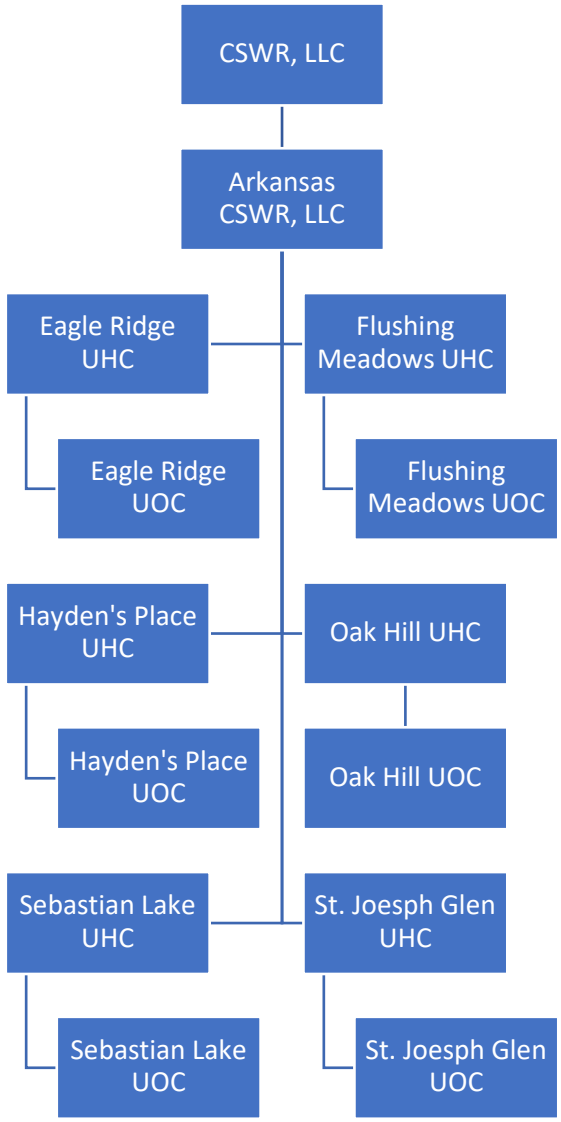

Exhibit MD-1

BEFORE THE ARIZONA CORPORATION COMMISSION

DOUG LITTLE
Chairman
BOB STUMP
Commissioner
BOB BURNS
Commissioner
TOM FORESE
Commissioner
ANDY TOBIN
Commissioner

ARIZONA CORPORATION COMMISSION INVESTIGATION INTO POTENTIAL IMPROVEMENTS TO ITS WATER POLICIES	DOCKET NO. W-00000C-16-0151 DECISION NO. 75743 ORDER

Open Meeting
September 7 and September 8, 2016
Phoenix, Arizona

BY THE COMMISSION:

* * * * * * * * * *

FINDINGS OF FACT

BACKGROUND

1. On July 25, 2016, the Arizona Corporation Commission ("Commission") issued Decision No. 75626 that directed Commission Staff to work with industry representatives to develop and present information for Commission review.

2. Further, Staff was ordered to establish a Commission Ombudsman office for small water companies and to work with industry representatives to evaluate ways to reduce the regulatory burden on small water companies.

3. The Decision required that certain information related to several of the policies and components thereof be made available for Commission review by September 1, 2016. The report provides an update on the status of these items and provides various documents for Commission review as directed.

THE WATER POLICIES WORK GROUP

4. The Water Policies Work Group ("Work Group") consists of members of Commission Staff in the Hearing and Utilities Divisions, Residential Utility Consumer Office ("RUCO"), the Water Utilities Association of Arizona ("WUAA"), the Rural Water Association of Arizona ("RWAA"), along with representatives from several water and wastewater companies including Arizona Water Company, EPCOR Water Arizona, Global Water, and Valley Utilities Water Company. The process was very open and collaborative. Input from all parties involved was incorporated into the end products that are being presented.

EMERGENCY SURCHARGES

5. The Work Group understands the desire of the Commission to lessen the regulatory obligations on smaller water companies while still protecting customers' interests. One policy that addresses this desire is the direction to facilitate an emergency surcharge process.

6. Class C, D or E water or wastewater utilities that face a water supply emergency may request an emergency surcharge. Decision No. 75626, directed the Work Group to evaluate by September 1, 2016, the Commission's current processing times for Emergency Surcharges, and to develop recommendations to allow a water or wastewater utility to receive a Commission vote on an emergency surcharge within 30 days and within 60 days after filing an initial surcharge application.

7. To meet this requirement the Work Group gathered input from the Hearing Division on a draft document of the Emergency Rate Case Application. This document was further refined by discussions of the Work Group. See Attachment A to the Status Update filed September 1, 2016 for the recommended processes that are the results of that group effort and the notice that would be required to be sent to customers at the time the applicant asks Staff to open a docket. Attachment A only specifically identifies the 30 day process; however, language was added to the attached document that, due to the unique circumstances of each case, and for good cause, any of the parties may request an extension of up to an additional 30 days.

8. The Work Group has recommended that the Commission adopt the Emergency Surcharges rate case process as detailed in Attachment A and discussed in the Status Update.

SHORT FORM RATE APPLICATION

9. Another policy facilitating the reduction of the regulatory burden on small water companies involves making available to smaller companies, some adjustor mechanisms that some larger utilities have been granted. These policies include making changes to the Short Form Rate Application currently available to small water companies to assist with the rate case process. Specifically, Staff was directed to update the Short Form Rate Application to include the schedules necessary for calculating purchased power, purchased water, and system improvement surcharges, and to include a formulaic method that will allow small utilities to calculate a Conservation Adjustment. Further, Staff was directed to revise the questions in the current application to better reflect what is actually needed to process a small company rate case.

10. The Work Group conducted an evaluation that included the information currently requested, any missing information whose inclusion would make the process more efficient, how to make the process easier in general, and how to incorporate the specific features ordered in the Decision. Through the collaborative effort of the Work Group, a Short Form Rate Application has been developed that includes all of the changes ordered in the Decision plus some additional changes that are intended to streamline the process, as discussed in detail below.

11. In its current format, the Short Form Rate Application is available only as a Word/PDF document. During the course of the evaluation, it was determined that in its current format, the application can be somewhat cumbersome and overly burdensome. Specifically, it was difficult to add columns where needed, some information between pages was duplicative, requesting all of the invoices for each of the expense items in the application was unduly burdensome, and some of the instructions were ambiguous, so much so that it wasn't always clear what was being requested.

12. The Work Group has recommended that the Commission make available an Excel spreadsheet that can be downloaded and completed. This would be the first and biggest step to making the process more efficient as discussed further throughout this summary. We believe that addressing the required modifications in a Word or PDF document would likely make it more difficult for small water companies to follow and/or use. Further, there are some efficiencies inherent in Excel that are not available in Word or Adobe. We understand that some of the smaller water companies may not

have extensive experience in Excel so the Work Group has recommended that once the changes are in place a version of this spreadsheet should be offered in a fillable PDF/Word format as an alternative.

13. In addition to the summary which explains all the changes that the Work Group has recommended for the Short Form Rate Application, there is an accompanying Excel workbook available for Commission review. Attachment B to the Status Update filed September 1, 2016 is the modified version of the Word document for the Short Form Rate Application. Attachment C to the Status Update filed September 1, 2016 contains the schedules for the recommended adjustor mechanisms.

14. The Work Group began this process by converting all of the tables included in the existing Short Form Rate Application into schedules in an Excel workbook. The schedules include links throughout which minimize the number of required and repeat inputs. There has also been some additional functionality built-in as detailed below, but in general this includes features such as drop-down menus and automatic formulas.

15. To make the process more efficient, the Work Group has recommended tying the Short Form Rate Application to the Annual Report. Combining this information makes for a smoother transition from the Annual Report to a rate case filing since the majority of the information required in the Annual Report is also requested in the Short Form Rate Application[1]. The Work Group has recommended developing parameters in the annual report form that would alert the filing company that it may want to consider filing a rate case[2].

16. While the Work Group has recommended the use of Excel, we have not recommended that Excel be used exclusively. Some of the information in the application logically still belongs in the current format, such as the general instructions, the checklist, background information, etc. See Attachment B for the recommendation of the Work Group.

17. The Work Group also has recommended that the Commission review the Short Form Rate Application as presented for review and provide further guidance for the Work Group on any additional modifications that may be necessary.

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1 The Work Group estimates that 70-80 percent of the information required in the Annual Report is also required in the Short Form Rate Application, as can be seen in the provided electronic version of the application.

2 For example, a Company operating at a net loss. This functionality has yet to be built into the workbook.

Detailed Changes to the Overall Short Form Rate Case Application:

18. First, the number of copies required throughout the application process for smaller companies has been reduced to two, as discussed in the June 14, 2016 Staff Meeting. Some of the information being requested in the checklist has been clarified, including a recommended materiality threshold of $250 for the operating expense invoices being requested. This materiality threshold is paramount for reducing the amount of time and resources spent by small utilities in preparing rate applications, and is consistent with the Standard of Materiality discussed later. The definition of an affiliated relationship has also been expanded, and the instructions have been updated to reflect all of the recommended changes[3]. A simplified example illustrating how income taxes are calculated has also been included.

Specific Changes to the Short Form Rate Case Application by Schedule:

19. The detailed changes as discussed in this section were made for efficiency purposes coupled with addressing the requirements of the Decision.

20. **Title sheet** – This is a new sheet that contains inputs for the plant in service, the accumulated depreciation and the fully depreciated plant balances that were approved in the last rate case. This information is then linked throughout as necessary. Having these inputs on the title page contributes to eliminating the need for any inputs on schedule 4 (Plant Summary) and schedule 5 (Utility Plant in Service).

21. **Schedule 1: Balance Sheet** – This was formerly pages 24-25 (now page 3). Added formulas and a way to flag for the Company's attention if the balance sheet does not in fact balance.

22. **Schedule 2: Water Company Plant Description** – This was formerly pages 17-18 (now page 5). No other changes.

23. **Schedule 3: Plant Summary** – This was formerly page 15 (now page 7). No longer requires any input, see the Title page comments.

24. **Schedule 4: Utility Plant in Service** – This was formerly page 16 (now page 8). No longer requires any input, see the Title page comments.

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3 For ease, instructions have also been imbedded on each schedule of the workbook that are applicable for that particular schedule.

25. **Schedule 5: Water Use Data Sheet** – This was formerly page 19 (now page 9). Added some of the information requested on the Annual Report to be consistent.

26. **Schedule 6: Bill Count Summary** – This was formerly pages 30-34 (now page 10). Removes the quarterly reporting requirement. Links to Schedule 7, and to the proof of revenue calculations.

27. **Schedule 7: Current and Proposed Rates** – This was formerly page 9 (now page 11). This schedule includes a drop-down box for the meter size and customer type that will allow the Company to select from a list of options. These selections will then link to the commodity charges section at the bottom of this schedule, the bill counts (Schedule 14), and the proof of revenue (hidden but linked to the income statement Schedule 8). In the existing Short Form Rate Application, it isn't clear that the rate information is required for all meter sizes and types, and is often missing when the Company has more than one meter size/type that it serves. These changes correct for this.

28. **Schedule 8: Current and Proposed Service Charges** – This was formerly page 11 (now page 12). Included now are the service line and meter charges that Staff typically has recommended. These are for illustrative purposes only and are not part of what will be printed as part of the application for the filing.

29. **Schedule 9: Income Statement** – This was formerly page 20 (now page 13). Added columns for the Company proposed adjustments. Also added a link to the proof of revenue which follows Staff's typical methodology for calculating revenues using the bill counts. This is intended to assist the Company with the accuracy of its filing and will hopefully speed up the sufficiency determination, which will also speed up the resolution of rate cases and reduce the amount of time between when the Company files the rate case and the date when rates become effective.

30. **Schedule 10: Calculation of Depreciation Expense** – This was formerly page 22 (now page 15). Reduced the number of required inputs by linking to other schedules and the Annual Report. Also input the depreciation rates that Staff typically has recommended as a reference for the Company. This schedule will now support the depreciation expense on a going forward basis that reflects the test year plant balances.

31. **Schedule 11: Pro Forma Additions/Subtractions** – Added this schedule, which will allow the Company to include pro forma adjustments along with explanations to the income statement (linked to Schedule 9).

32. **Schedule 12: Pro Forma Property Tax** – Also added a pro forma schedule specific for property taxes that will reflect the property taxes using the formula approach, under the Company proposed revenues (linked to Schedule 9).

33. **Schedule 13: Customer Notice –** The existing version of the Short Form Rate Application requires that the Company notice its customers on the same day that the application is filed. The Work Group discussed this requirement and determined that it does not need to be done on the same day and that it would likely be easier for small utilities if it weren't. Therefore, the Work Group has recommended that the notice be sent out by the Company as soon as sufficiency is issued. This requirement would be consistent with the process for larger utilities. The notice was, and still is the last page in the document.

34. **Schedule 14: Free Cash Flow** – Added a schedule that links to the other schedules that will show the free cash flow of the Company. This will assist the Company with setting the proposed revenue requirement.

35. **Schedule 15: Water Conservation Adjustment** – Added a schedule that will calculate a water conservation adjustment (utilizing a formulaic method) given the average usage per customer in the test year as compared to a prior period(s) (Annual Reports or test year in the last rate case).

36. **Schedule 16: Purchased Water Adjustor Mechanism ("PWAM")** – Added a PWAM schedule. This is a more simplistic model for small water companies that is based on the more complex models that have been approved by the Commission in rate cases for larger utilities.

37. **Schedule 17: Purchased Power Adjustor Mechanism ("PPAM")** – Added a PPAM schedule. This is a more simplistic model for small water companies that is based on the more complex models that have been approved by the Commission in rate cases for larger utilities.

38. **Schedule 18: Systems Improvement Fund Surcharge ("SIFS")** – Added a SIFS Schedule. This is a version of the Systems Improvement Benefit ("SIB") surcharge that has been approved by the Commission in rate cases for larger utilities. This schedule is intended for Class D and

E companies with a large enough rate base for the revenue requirement to be set using a rate of return. An option discussed in the Decision, for those companies with very little or negative rate base, is an Emergency repair and replacement fund. The Work Group believes that the particulars of this surcharge is in part a policy issue to be decided within a rate case, that could be coupled with another directive before the Work Group, specifically that of the development of a standard minimum operating margin.

39. **Schedule 19: Checklist** – Added a copy of the expense items portion of the checklist (mirroring the word/PDF version of the application) that requires copies of invoices. Also added a template for each expense item that companies can use in putting together their applications.

40. **Work paper 1: Plant Additions and Retirements by Year** – This was formerly page 14. The Work Group has recommended that instead of this being a schedule that is included with the filing this be included as a work paper that will be made available for Staff's audit. The number of pages that would be required to print would vary depending on the number of years since the last rate case, but to include this as a work paper instead would reduce the number of pages that are printed.

41. **Work paper 2: Plant Accumulated Depreciation** – This is a new addition that requires no input by the Company but can be used to assist in the filing by calculating the accumulated depreciation as a check figure. This work paper is linked to work paper 1.

42. **Work paper 3: Advances in Aid of Construction** – This was formerly page 27. In addition to recommending that this now be a work paper instead, the Work Group has added an input for the balance of AIAC that was approved in the last rate case. The Work Group also has recommended splitting out the different categories of AIAC to make the process simpler by reducing the need for future data requests for this information. This work paper is linked to work paper 1.

43. **Work paper 4: Gross Contributions in Aid of Construction** – This was formerly page 28. In addition to recommending that this now be a work paper instead, the Work Group has added an input for the amortization of CIAC. This work paper is linked to work paper 1.

44. **Work paper 5: Supplemental Financial Information** – This was formerly page 26. No changes other than to include as a work paper. This work paper is linked to the Annual Report.

45. The Work Group realizes that the Short Form Rate Application will evolve over time, and that flexibility is key in developing a product that will be beneficial for all parties involved. In

addition to the Work Group, the Excel version of the application being presented was also reviewed by a representative of an ownership group that operates four small Class D and E water companies, and his input was incorporated. The Work Group intends for the application to be reviewed by additional small water companies and operators to solicit additional input. Another crucial step in the evaluation process will be working with a small water company to file an actual rate application utilizing the Excel version. The Work Group anticipates that these additional steps will occur at some as yet to be determined point in the future.

46. The Work Group is also still working through the process of a Short Form Rate Application for wastewater companies. The question was posed, "Should there be a short form application for wastewater?" The Work Group's answer is that there should be a version created specifically for wastewater utilities; however, because there are far more regulated water utilities the focus has been on updating the water application. As such the Work Group has recommended that the Commission be given the opportunity to review the recommended changes as presented for the water application. Once further direction is given then the Work Group can develop a similar wastewater application.

ESTABLISH STANDARD OF MATERIALITY

47. Another item detailed in the Small Water Company Rate Case Issues section addressed materiality. This policy states that Staff's audits of small water companies should focus on issues likely to materially impact rates. It also states that any accounting issues that have minimal impact on rates need not be addressed in a small water utility rate case. As such, the Decision directs Staff to develop a standard of materiality that takes into account rate impacts. The Work Group developed the following materiality guidance for the Commission's review and consideration.

Materiality Guidelines:

48. As trained accountants and auditors, Staff members have an academic understanding of "materiality." What is deemed to be material in one set of circumstances may be clearly immaterial in another set of circumstances. When exercising regulatory auditor discretion, Staff needs to be mindful of both the big picture and of any applicable policy statements or positions of the fact finder. The overriding consideration should be whether a particular data request or adjustment will materially change

the revenue requirement. The "Materiality Levels by Class" chart below provides guidance on what sort of data requests and adjustments are appropriate in different circumstances.

49. Staff is expected to think and utilize reason in applying these materiality guidelines and in reaching recommendations. However, there are four general guidelines that should be specifically applied and followed when assessing materiality and when developing recommendations. These four general guidelines are discussed below. Likewise, an auditor's decision to pursue additional discovery should be undertaken only after giving specific consideration to the materiality of the issue being evaluated. That is, if the answer to a data request is not likely to materially affect the revenue requirement, then the data request should not be sent unless there is some other clearly articulated reason for needing the information.

Four General Guidelines:

a. Always consider the magnitude of the adjustment under consideration to the big picture. Is the total underlying rate increase request only $50,000? If so, then an adjustment of $2,000 is probably material whereas a possible adjustment of $500 is probably not material enough to recommend. The following table provides some specific guidance:

Material Levels by Class

		Representative	Expense			Rate Base	
	Revenue	Revenue	Expenses	Data Request Threshold	Adjustment	Data Request Threshold	Adjustment
Class C	1 to 3 Million	$2,000,000	$1,700,000	$400	$2,000	$1,000	$5,000
Class D	.250 to 1 Million	625,000	562,500	250	1,000	500	3,000
Class E	< 250,000	125,000	112,500	250	250	500	1,000

Data Request Threshold = Default minimum level of individual expenditures that would be reviewed, e.g. the level above which copies of invoices would be provided.
Adjustment = Default minimum amount required to recommend an adjustment to an individual account.

b. If the adjustment under consideration is the result of a companion adjustment, then capture the smaller adjustment in order to assure consistency and completeness in Staff's overall position. For example, if Staff proposes a $5,000 adjustment to payroll, it is likely that a companion adjustment will also be needed to applicable payroll taxes. In this instance, the accompanying adjustment may only be $400. The amount of this

accompanying adjustment may be too small to consider making as a separate recommendation, but it is none-the-less important to include the accompanying adjustment to assure consistency and completeness in Staff's overall recommendation. There is a secondary approach to these companion adjustments that warrants discussion. If the companion or synchronizing secondary adjustment is truly immaterial, Staff may elect to omit this secondary adjustment. Under such circumstances, it is crucial that it is noted in testimony or in the Staff Report that Staff is choosing to pass on this adjustment because of the immaterial magnitude of the secondary adjustment.

c. If the net calculable dollar value of two or more adjustments is immaterial, but the individual components are by themselves material, then the size of the net value is not the deciding factor. However, it is very important to make it clear in testimony or in the Staff Report, that it is the Commission's consideration of the individual components that is important and that focus should not be on the net dollar value of the adjustments. For example, a net impact of $300 to repairs and maintenance expense would appear to be an immaterial adjustment; however, if this net value is actually composed of one recommended increase of $90,000 and a recommended decrease of $89,700 then the issues being addressed are clearly material.

d. Always consider – "would a fact finder or other party (such as the Utilities Division Directors, Administrative Law Judges or Commissioners) to the docket, agree that the Staff decision to pursue or not pursue a recommendation in a particular area was reasonable?" From a discovery perspective was the request for more support from the applicant warranted from a materiality point of view? For example, would the fact finder conclude that **it appears** that Staff chose to ignore possible minor adjustments only when the adjustments went in the filing utility's favor? Perception of the decision and actions must always be considered.

Additional Ratemaking Factors Influencing Materiality Decisions:

50. Staff also has a set of additional ratemaking factors that will have relevance when gauging materiality.

Rate Base:

51. The Staff regulatory auditor should keep in mind that adjustments to a utility's rate base only impact the utility's annual revenue requirement by the utility's ROR multiplied by the rate base adjustment (plus income tax gross up.) For example, a rate base adjustment of $1,000 will only change revenue requirement by $100 if the ROR is 10 percent (this example ignores possible income tax considerations).

Operating Income – Revenues and Expenses:

52. Adjustments to revenue and expense have a dollar for dollar impact to the utility's annual revenue requirement, again ignoring any income tax considerations. That is, a proposed adjustment of $1,000 to salaries expense will change the utility's annual revenue requirement by $1,000 (up or down).

Policy Considerations:

53. Except in cases when the impact of an adjustment is extremely small, the auditor should always capture adjustments that relate to a general Utilities Division policy.

Responding to Filing Utility Proposed Adjustments:

54. A filing utility often sets the materiality threshold in a case. For example, if a filing utility proposes an adjustment of $100, Staff must still evaluate this proposal. However, Staff should not feel obligated to make adjustments to such a small amount even if small errors in the Company's supporting calculations are found.

Seek Additional Guidance When Necessary:

55. If Staff has doubts whether or not to pursue an adjustment or issue discovery, due to materiality, it may be best to consider just passing on the adjustment, or at least to discuss the matter with a manager.

Proof of Revenues:

56. When it comes to ensuring that the rate design either proposed by the filing utility or by Staff, in fact, generates the annual revenue target, materiality considerations must be approached judiciously. While input from the Staff Manager may be needed in certain cases, Staff generally requires the proof of revenues (associated with existing or proposed rate designs) to be very close to targeted

revenues. The reason for this is simple. Annual revenues recorded are a mathematical function of the ACC-approved billing rates and the utility's billing determinants[4].

57. Staff should give proper consideration to any reconciling evidence provided by the utility (such as meter reading problems which required manual corrections to customer bills, or even possible cycle billing considerations). But, generally as noted, it should be possible to reconcile a rate design to within 1 percent of targeted revenues.

Rate Filing Sufficiency Reviews:

58. Except for materiality considerations related to Staff's proof of revenue analysis, Staff should not spend time trying to work through either the reasonableness of proposed adjustments or the materiality of company proposed adjustments during Staff's rate filing sufficiency reviews. The focus of such reviews is on the completeness of the filing (does the rate filing meet the ACC's minimum filing requirements for this utility?)

Conclusion:

59. Staff is to present a balanced and reasonably developed financial picture. Staff's recommendations should reflect a balanced consideration of the filing and the recommendations should position the filing utility where it can have a reasonable opportunity to pay its ongoing expenses while also earning a reasonable rate-of-return and income.

60. The Work Group has recommended that the Commission adopt the Standard of Materiality as put forth in the Status Report.

DEFINE VIABLE AND NON-VIABLE

61. Prior to implementing the Commission "Policy Regarding Direct Incentives for Acquisitions" or the "Policy Regarding the Acquisition of Viable Systems", the Commission directed the Work Group to define "viable" and "non-viable". The Work Group was also asked to evaluate and define "a demonstrated record of acquiring and improving the service provided to the customers of non-viable water systems" and couple those metrics with recommended ROE adders.

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4 Billing determinants would include the monthly number of customers and the respective monthly usage levels for each customer class.

62. To meet this mandate the industry members of the Work Group created draft documents of the definitions that served as the genesis for future revisions and guided the various meetings where these definitions were discussed. The Work Group diligently and collaboratively worked together to develop the following definitions on which all parties agree. The following information is the result of this process.

Definitions of Viable and Non-Viable Pertaining to Small Water and Wastewater Utilities:

63. The United States Environmental Protection Agency (EPA) has defined viable water systems as systems that have, "the technical, financial, and managerial capability to consistently comply with current and prospective performance requirements."[5] The Arizona Corporation Commission used a similar definition in its Policy Statement No. 5 of Decision No. 75626, dated July 25, 2016, concerning the consolidation of small water and wastewater utilities.

A viable water and/or wastewater utility is defined as one that:

1. Maintains the managerial, technical and financial capabilities to safely and adequately operate; and
2. Is currently in compliance with all Arizona Department of Environmental Quality, Arizona Department of Water Resources, and Arizona Corporation Commission rules and orders; and
3. Will be able to meet other requisite regulatory requirements on a short and long-term basis.[6]

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[5] EPA, Methods for Assessing the Viability of Small Water Systems: A review of Current Techniques and Approaches, August, 1995. Located at: http://nepis.epa.gov/Exe/ZyNET.exe/20001RR9.TXT?ZyActionD=ZyDocument&Client=EPA&Index=1995+Thru+1999&Docs=&Query=&Time=&EndTime=&SearchMethod=1&TocRestrict=n&Toc=&TocEntry=&QField=&QFieldYear=&QFieldMonth=&QFieldDay=&IntQFieldOp=0&ExtQFieldOp=0&XmlQuery=&File=D%3A%5Czyfiles%5CIndex%20Data%5C95thru99%5CTxt%5C00000001%5C20001RR9.txt&User=ANONYMOUS&Password=anonymous&SortMethod=h%7C-&MaximumDocuments=1&FuzzyDegree=0&ImageQuality=r75g8/r75g8/x150y150g16/i425&Display=p%7Cf&DefSeekPage=x&SearchBack=ZyActionL&Back=ZyActionS&BackDesc=Results%20page&MaximumPages=1&ZyEntry=1&SeekPage=x&ZyPURL#

[6] W-00000C-16-0151, Decision No. 75626, at page 19 of Attachment No. 1, lines 6-11.

A non-viable water or wastewater utility is defined as one that:

1. Lacks and is unable to acquire the managerial, technical and/or financial capabilities to safely and adequately operate; or
2. Is currently not in compliance or is unable to achieve compliance with Arizona Department of Environmental Quality, Arizona Department of Water Resources, and/or Arizona Corporation Commission rules or orders or is unable to achieve such compliance without managerial, technical, or financial assistance; or
3. Will not be able to meet other requisite regulatory requirements on a short- or long-term basis.

64. When making the determination of viability or non-viability, the Commission will consider all of the relevant circumstances of the case and will determine the question of viability or non-viability based on all of the circumstances at the time of the CC&N transfer.

65. Non-viability in the short or long-term is different from failure where a utility has deteriorated to the point where it presents a danger to public health and safety, but the same types of facts may indicate a utility has become non-viable before it reaches a failed state. Dockets in which 1) the ACC Staff has filed for the appointment of an interim manager and/or operator or 2) water or wastewater utilities have filed for emergency rate relief, are indicative of a water or wastewater utility that is susceptible to failure.

66. The following is not an exhaustive list, but are examples of factors that may be present when a utility is non-viable. Any one of these factors, or any combination of factors could be sufficient to show that a utility is non-viable.

- The utility lacks and is unable to acquire the managerial, technical and/or financial capabilities to:
  - Perform necessary operations and maintenance to assure an adequate, safe, and permanent water supply and/or adequate, safe treatment of wastewater which may include:
    - Maintaining and improving essential equipment.

- Properly addressing growth in excess of the current capacity of the utility.
- Failing to properly address any needs for significant capital improvements due to aging infrastructure and an inability to attract investment or obtain financing for needed improvements.
- Contaminants in excess of drinking water or wastewater standards.
- Failure to consistently or properly perform required testing.
- Failure to ensure compliance with new drinking water or wastewater treatment standards in effect or going into effect.

- There is a lack of adequate staffing and/or certified operators due to the inability of the utility to attract, hire, and retain engineers, attorneys, accountants, etc. to properly operate the utility.
- A failure to file for regular rate increases and/or the inability to hire experts that may be needed to assist with processing rate cases, that contributes to rates that fail to cover expenses and liabilities, such as required repairs and maintenance, or to cover debt service requirements.
- Is unable or unwilling to ensure adequate supply or treatment capabilities demonstrated by:
  - Insufficient or lack of storage leading to water outages or repeated water shortages.
  - The frequent triggering of curtailment tariffs.
  - The utility relying on hauling or otherwise purchasing water on an emergency basis to meet demand.
  - Implementation of a moratorium on new service connections or the inability to add new service connections due to low supplies or pressure.
- Issues with billing such as a failure to bill (i.e. family members, friends, acquaintances, etc.), sporadic billing, or inaccurate billing.
- The utility is in bankruptcy or is considering bankruptcy.

- The owner and/or operator have walked away from the utility.
- There isn't a clear plan in place in the event of an owner passing away or becoming unable to continue running the utility.
- Inability or unwillingness to respond to complaints or requests for service.

- Is not in compliance with Arizona Department of Environmental Quality, Arizona Department of Water Resources, and/or Arizona Corporation Commission rules or orders such as:
  - Outstanding violations, a history of violations; and/or the inability or unwillingness to correct violations.
  - Existing mandates for significant capital improvements such as new treatment systems and an inability to meet the mandates.
  - Failure to obtain approvals to construct, approvals of construction, discharge authorizations or other required permits.
  - The utility is not current on sales and/or property taxes.
- Will not be able to meet other requisite regulatory requirements on a short or long-term basis:
  - The utility's Certificate of Convenience and Necessity has been revoked.
  - Accounting systems are not kept in accordance with required standards.
  - There is a failure to properly complete and/or submit annual reports to the Utilities Division.
  - Appointment of an interim manager or operator.
  - The utility has filed an application for interim rates or emergency rates.
  - The setting of adequate rates would be unduly burdensome with the existing customer base.

67. Class C, D, and E utilities have fewer customers and consequently lower revenues than Class A and B utilities do, yet they generally must meet all the same financial, managerial and technical requirements as the larger companies. As a result, Class C, D and E utilities may be particularly susceptible to being non-viable for either the short or long term.

68. A determination that a utility is non-viable shall be used only in the assessment of whether acquisition incentives are appropriate should that utility be acquired. A non-viable determination is not intended to create new compliance burdens on a utility that otherwise would not exist. The intent here is to help non-viable utilities (and their customers), not to punish these companies simply because they have been designated as non-viable.

69. The Work Group has recommended that the Commission adopt the definitions of Viability and Non-Viability as put forth in the Status Update.

Demonstrated Track Record

70. Another key factor in the acquisition process is the established demonstrated track record. While the Work Group agrees on the definitions of viable and non-viable, there are valid yet differing points of view as to whether the definition of a non-viable utility can be applied retroactively. Ultimately the Work Group agreed that this was a policy decision best left to the Commission, and presents the following two options for the Commission's consideration.

71. A demonstrated track record of acquiring and improving the service provided to customers of non-viable water systems is defined as:

Option 1 – No time restriction

> A utility that has acquired multiple non-viable water and/or wastewater utilities and that has made reasonable, prudent and timely investments, which resulted in the acquired utility becoming viable. The acquiring utility shall bear the burden of demonstrating a track record. In each case, the Commission will consider all of the relevant circumstances in determining whether a track record of acquiring and improving the service provided to customers of non-viable water and/or wastewater utilities has been demonstrated.

Option 2 – Limited to acquisitions post decision

> A utility that has acquired multiple non-viable water and/or wastewater utilities since the ACC issued Decision No. 75626[7], and that has made reasonable, prudent and timely investments, which resulted in the acquired utility becoming viable. The acquiring utility

7 Effective date of Decision No. 75626 is July 25, 2016.

shall bear the burden of demonstrating a track record. In each case, the Commission will consider all of the relevant circumstances in determining whether a track record of acquiring and improving the service provided to customers of non-viable water and/or wastewater utilities has been demonstrated.

72. The Work Group did not attempt to couple these metrics with the recommended ROE adders; instead, it recommended that the chosen definition be coupled with ROE adders as part of the Cost of Capital reform that the Work Group is still in the process of completing.

RULEMAKING

73. The Decision orders Staff to commence a rulemaking to consider the following amendment to Arizona Administrative Code ("A.A.C.") R14-2-803.D: "A notice of intent under this section is not required when the reorganization of an existing Arizona water or wastewater public utility holding company is due to the purchase of the shares (or merger of) a Class D or E water or wastewater utility." On August 31, 2016, Staff opened docket RU-00000A-16-0300, to initiate the process.

STATUS SUMMARY

74. Following are recommendations:

1. Staff should be directed to post the Emergency Rate Case Application (set forth in Attachment A) on the Commission's website to make it available for use by utilities. Staff should also be directed to continue to look for ways of improving the efficiency of the emergency surcharge process.
2. Staff should be directed to post the Short Form Rate Case Application (as discussed in this report) on the Commission's website to make it available for use by utilities. Staff should also be directed to continue to look for ways of improving the Short Form Rate Case Application.
3. The Commission could adopt the "Materiality Guidelines" and the definitions of "viable" and "non-viable", as set forth herein, as Commission policies in order to provide guidance to Staff and to stakeholders.
4. As discussed on pages 18-19, the Commission should determine which of the two options for the definition of "demonstrated track record" it prefers, and

should then adopt that choice as a Commission policy in order to provide guidance to Staff and to stakeholders.

75. Regarding the proposed definitions for "Demonstrated Track Record," we adopt the No time restriction option as our policy on this issue. Although both options have their respective merits, we believe that the No time restriction proposed option best reflects our objectives as set forth in Decision No. 75626.

76. Under the guidance of Decision No. 75626, the Work Group has taken steps to define, refine, propose, and implement actions which will significantly improve the regulatory process surrounding small water companies in Arizona. The Work Group should continue forward with making improvements.

77. The purpose of establishing acquisition premiums for non-viable companies and "giving credit" to viable companies that purchase them is to incentivize water system consolidation across the state. We know that when a viable company provides service to customers, customers benefit from that company's financial, managerial, and technical competence. The last thing we want to do is be an impediment to that goal. The Arizona Department of Environmental Quality ("ADEQ") has also expressed similar sentiments for all water systems (including those regulated by the ACC). Some industry stakeholders, however, have expressed concern that certain regulatory enforcement actions against a prospective new owner of a non-viable water system may actually discourage or inhibit that acquisition due to potential negative perceptions in the financial community that some regulatory actions, both formal and informal, may cause.

78. These Stakeholders raise legitimate concern, yet they must be balanced with the Commission and ADEQ's primary obligation: the health and welfare of Arizonans. We possess enforcement authority to assure that the new owner is:

a. Making reasonable progress with identifying system deficiencies;

b. Making reasonable progress with correcting identified deficiencies; and

c. Is regularly communicating findings/updates with pertinent regulatory agencies (e.g., ACC, ADEQ, etc.)

We direct ACC Staff to engage with ADEQ and develop a Joint Policy Statement and/or a Memorandum of Understanding dealing with the acquisition of small troubled water utilities. The Joint Policy Statement and/or Memorandum of Understanding should lay out a process that assures the health and safety of the acquired company on a reasonable schedule. The process should be designed to minimize regulatory actions that might exacerbate the financial risk associated with purchasing small companies with compliance issues. Staff is directed to provide the Joint Policy Statement and/or a Memorandum of Understanding for Commission review (or to report on the state of discussion with ADEQ) by October 30, 2016.

CONCLUSIONS OF LAW

1) The Commission has jurisdiction over the matters discussed herein pursuant to Article XV of the Arizona Constitution and Title 40 of the Arizona Revised Statutes.

2) The recommendations set forth in Finding of Fact no. 74 are reasonable, and we adopt them.

3) The Commission, having reviewed the Status Update dated September 1, 2016, concludes that it is in the public interest to adopt the policies as discussed herein.

4) We adopt Findings of Fact nos. 48 through 60 as our policy statement regarding "Materiality Guidelines."

5) We adopt Findings of Fact nos. 63 through 68 as our policy statement regarding the definitions of "viable" and "non-viable."

6) We adopt Findings of Fact nos. 70 through 72, and 75 as our policy statement regarding the definition of "Demonstrated Track Record."

7) Our policy statements, as discussed herein, are intended to provide helpful information and guidance to Staff and stakeholders, and are not intended as generally applicable requirements.

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ORDER

IT IS THEREFORE ORDERED that Staff shall post the Emergency Rate Case Application (set forth in Attachment A to the Status Update) on the Commission's website to make it available for use by utilities.

IT IS FURTHER ORDERED that Staff shall continue to look for ways to improve the efficiency of the emergency surcharge process.

IT IS FURTHER ORDERED that Staff shall post the Short Form Rate Case Application (as discussed in this report) on the Commission's website to make it available for use by utilities.

IT IS FURTHER ORDERED that Staff shall continue to look for ways to improve the Short Form Rate Case Application process.

IT IS FURTHER ORDERED that the "Materiality Guidelines", as set forth herein, is adopted as a Commission policy.

IT IS FURTHER ORDERED that the definitions of "viable" and "non-viable", as set forth herein, is adopted as a Commission policy.

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IT IS FURTHER ORDERED that the definition of "demonstrated track record" as set forth in Findings of Fact nos. 70 through 72 and 75 is adopted as a Commission policy.

IT IS FURTHER ORDERED that this Order shall become effective immediately.

BY THE ORDER OF THE ARIZONA CORPORATION COMMISSION

CHAIRMAN LITTLE COMMISSIONER STUMP

COMMISSIONER FORESE COMMISSIONER TOBIN COMMISSIONER BURNS

IN WITNESS WHEREOF, I, JODI JERICH, Executive Director of the Arizona Corporation Commission, have hereunto, set my hand and caused the official seal of this Commission to be affixed at the Capitol, in the City of Phoenix, this 19th day of September, 2016.

JODI JERICH
EXECUTIVE DIRECTOR

DISSENT: _____

DISSENT: _____

TMB:BB:nr/RRM

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ATTACHMENT A

ARIZONA CORPORATION COMMISSION

REQUIREMENTS TO PROCESS AN
EMERGENCY RATE CASE APPLICATION WITHIN 30 DAYS

One or more of the following conditions must exist before a Company files an emergency rate application:

- A sudden change brings hardship to the Company;
- The Company is insolvent; or
- The condition of the Company is such that its ability to maintain service pending a permanent rate determination is in serious doubt.

Once a Company determines that it qualifies for emergency rate relief, it should contact the Commission's Utilities Division ("Staff") to ask Staff to open a docket. Once a docket is opened, the Company should mail a notice to customers informing them of the Company's intent to request an emergency rate case prior to filing the application. The notice must include information on the emergency request as well as the location customers can find additional information regarding the pending case.

The application must contain the following information/documentation:

- A narrative cover sheet(s) devoted to the explanation of the emergency condition(s) present in the Company;
- A requested amount of dollars to be recovered in the emergency rate;
- An emergency rate charge to apply to customers;
- A method or mechanism to recover the requested amount of dollars;
- A detailed breakdown of the system repairs, if any, necessary to alleviate the emergency condition. To include information such as size, quantity, capacity, and condition of all repair areas, and a listing for the cost of labor per repair item;
- A copy of an estimate of the cost of repairs;
- Certification that notice of the emergency rate application has been mailed to customers, in a form acceptable to Staff; and
- A copy of the notice mailed to customers.

For Class C, D, and E utilities, the Company must file the original emergency rate application, along with one (1) hard copy, with Docket Control, 1200 West Washington Street, Phoenix, Arizona, 85007. (Class A and B utilities are required to file an original and fifteen (15) copies.)

The Commission's Hearing Division will schedule a Procedural Conference to occur within five (5) business days of the filing of the application to discuss hearing dates and other procedural issues. The Administrative Law Judge ("ALJ") assigned to the matter will set a hearing date as soon as possible based on the availability of the parties and their ability to prepare their respective cases for presentation at the hearing. The ALJ will also direct the Company to work with Staff to provide notice of the

hearing date by means of posting notice in a conspicuous location within the affected communities, emailing notice to customers, and/or posting on the Company's website (or by other appropriate means), to allow an opportunity for customers to attend the hearing and provide public comment.

At the hearing, the Company and Staff (and any intervenors) will provide verbal testimony to present their positions and analysis regarding the Company's application. In most circumstances, Staff will not provide written documents or schedules in advance of the hearing. At the conclusion of the hearing, the ALJ will take the matter under advisement and issue a Recommended Opinion and Order ("ROO") within one week. The ROO will require, among other things, that the Company file a permanent rate case application by a specified date set by the Commission anywhere from six to 24 months of the Commission's Decision on the emergency rate application; and that the rates approved by the Commission are subject to customer refund in the permanent rate case.

Depending on the Commission's Open Meeting schedule, the emergency rate application may be decided by the Commission within 30 days. However, due to the unique circumstances of each case, the requirement to process the emergency rate case within 30 days may be extended to within 60 days at the request of the Company or Staff, or on the Commission's own initiative, for good cause.

**PUBLIC NOTICE OF THE APPLICATION OF <ABC WATER COMPANY>
FOR AN EMERGENCY RATE INCREASE
(DOCKET NO. <INSERT DOCKET NUMBER>)**

On <insert month and day, year> ("<ABC WATER COMPANY>" or "Company") filed with the Arizona Corporation Commission ("Commission") an Application for an emergency rate increase. The Company claims that it is entitled to emergency rate relief because <insert explanation of the emergency condition>. The Company estimates that it will incur $_____ in costs to alleviate the emergency condition. The Company is requesting authorization to recover $_____ in emergency rates by implementing a monthly surcharge in the amount of $ _____ per customer.

The Commission's Utilities Division ("Staff") is in the process of reviewing and analyzing the Application. Neither Staff nor any intervenor(s) has yet made any recommendation regarding the Company's request. The Commission is not bound by the proposals made by the Company, Staff, or any intervenor(s), and the Commission may approve the amount of the request, modify the amount higher or lower, or deny the request.

If you have any questions concerning how the Application may affect your bill or have other substantive questions about the Application, you may contact the Company at: <Company to insert name, address, telephone number, and email address for customer contacts concerning the Application>.

How You Can View or Obtain a Copy of the Application

Copies of the Application are available from <Company to insert how and where available>; at the Commission's Docket Control Center at 1200 West Washington Street, Phoenix, Arizona, during regular business hours; and on the Commission's website (www.azcc.gov) using the e-Docket function.

Arizona Corporation Commission Public Hearing Information

The Commission will hold a full public hearing on this matter. The Commission's Hearing Division will schedule a procedural conference to occur within five business days of the filing of the Application in order to set a public hearing date and establish other procedural requirements.

The Company will provide notice of the hearing date by means of posting notice in a conspicuous location within the affected communities, emailing notice to customers, and/or posting on the Company's website (or by other appropriate means), to allow an opportunity for customers to attend the hearing and provide verbal public comment.

Public comments will be taken on the first day of the hearing. Written public comments may be submitted at any time by mailing a letter referencing **Docket No. <insert docket number>** to Arizona Corporation Commission, Consumer Services Section, 1200 West Washington, Phoenix, AZ 85007, or by submitting comments on the Commission's website (www.azcc.gov) using the "Submit a Public Comment for a Utility" function. If you require assistance, you may contact the Consumer Services Section during regular business hours at 602-542-4251 or 1-800-222-7000.

About Intervention

The law provides for an open public hearing at which, under appropriate circumstances, interested persons may intervene. An interested person may be granted intervention if the outcome of the case

will directly and substantially impact the person, and the person's intervention will not unduly broaden the issues in the case. Intervention, among other things, entitles a party to present sworn evidence at hearing and to cross-examine other parties' witnesses. **Intervention is not required if you want to appear at the hearing and provide public comment on the Application, or if you want to file written comments in the record of the case.**

To request intervention, you must file an **original plus one hard copy** (if the application is for a Class A or B utility, an original plus 13 hard copies are required) of a written request to intervene with Docket Control, 1200 West Washington Street, Phoenix, AZ 85007, no later than <Company to insert date 5 business days following the filing of the Application>. You also **must** serve a copy of the request to intervene on each party of record on the same day that you file the request to intervene with the Commission. **Information about what intervention means, including an explanation of the rights and responsibilities of an intervenor, is available on the Commission's website (www.azcc.gov) using the "Intervention in Utility Cases" link.** The link also includes sample intervention requests.

If you choose to request intervention, your request must contain the following:

1. Your name, address, and telephone number, and the name, address, and telephone number of any person upon whom service of documents is to be made, if not yourself;
2. A reference to **Docket No. <insert docket number>;**
3. A short statement explaining:
    a. Your interest in the proceeding (e.g., a customer of the Company, etc.);
    b. How you will be directly and substantially affected by the outcome of the case; and
    c. Why your intervention will not unduly broaden the issues in the case;
4. A statement certifying that you have served a copy of the request to intervene on the Company or its attorney and to all parties of record in the case; and
5. If you are not represented by an attorney who is an active member of the Arizona State Bar, and you are not representing yourself as an individual, sufficient information and any appropriate documentation to demonstrate compliance with Arizona Supreme Court Rules 31, 38, 39, and 42, as applicable.

The granting of motions to intervene shall be governed by A.A.C. R14-3-105, except that **all motions to intervene must be filed on or before <Company to insert date 5 business days following the filing of the Application>.**

If you do not intervene in this proceeding, you may not receive any further notice of the proceedings in this docket. However, all documents filed in this docket are available online (usually within 24 hours after docketing) at the Commission's website (www.azcc.gov) using the e-Docket function. You may choose to subscribe to an RSS feed for this case using the e-Docket function.

ADA/Equal Access Information

The Commission does not discriminate on the basis of disability in admission to its public meetings. Persons with a disability may request a reasonable accommodation such as a sign language interpreter, as well as request this document in an alternative format, by contacting Shaylin Bernal, ADA

Coordinator, voice phone number at 602-542-3931, and email at SABernal@azcc.gov. Requests should be made as early as possible to allow time to arrange the accommodation.

ARIZONA CORPORATION COMMISSION

RATE APPLICATION
FOR WATER COMPANIES
WITH ANNUAL GROSS OPERATING REVENUES
(INCLUDING REQUESTED RATE RELIEF)
OF LESS THAN $1,000,000
PER ARIZONA ADMINISTRATIVE CODE R14-2-103

Details at website: www.azcc.gov

_____

UTILITY NAME

_____

TEST YEAR ENDED

Required invoices to be submitted are listed in the checklist on page 1.

You must complete ALL items in the application according to the instructions provided. If you have any questions regarding the application please call (602) 542-4251 for Staff assistance or see our website at: **www.azcc.gov**

IN ORDER TO PROCESS YOUR APPLICATION
PLEASE FORWARD THE ORIGINAL
PLUS ONE COPY OF THE
APPLICATION

ARIZONA CORPORATION COMMISSION
DOCKET CONTROL CENTER
1200 WEST WASHINGTON STREET
PHOENIX, ARIZONA 85007

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Petitioner's Exhibit MD-2: Arizona Policy on Acquisition Adjustment Recovery

WATER RATE APPLICATION CHECKLIST

Please use the following checklist to ensure that all necessary attachments are included in the application. Provide an explanation for any omitted item.

ORIGINAL APPLICATION PACKAGE ITEMS

☐ 1. Please include the original plus one additional copy of this application in your submission. Be sure to download the accompanying excel spreadsheet portion of the application and complete all of the schedules. Failure to fill out and include these schedules will result in an insufficient application. In addition be prepared to provide Staff with an electronic copy of the spreadsheet upon request.

☐ 2. The Arizona Department of Revenue ("ADOR") certificate of compliance letter of good standing. To request a certificate of compliance, use the Tax Clearance Application (Form# 10523) found on the ADOR website at http://www.azdor.gov/Forms/Other.aspx. (Send in the certificate of compliance with your application.)

☐ 3. The utility's most recent Arizona Department of Environmental Quality ("ADEQ") annual sampling fee invoice for its Monitoring Assistance Program, and invoices for all other water testing conducted during the Test Year. (Acct. 635)

☐ 4. (Plant Additions) - Please provide a list of all plant additions by year and NARUC plant account number. For each plant addition project with **over** $500 in total costs, please provide (1) a list showing the individual cost components of the plant addition and (2) invoices to support each cost component shown on the list. Please cross-reference the amounts on the list to the invoices.

☐ 5. (Salaries and Wages) – Please provide a breakdown by position, salary, and duties for all of the Company's employees. (Acct. 601)

☐ 6. (Purchased Water) – Please provide (1) a list showing the individual cost components of the total purchased water expense and (2) invoices to support each cost component over $250 shown on the list. (Acct. 610)

☐ 7. (Purchased Power) – Please provide (1) a list showing the individual cost components of the total purchased power expense and (2) invoices to support each cost component over $250 shown on the list. (Acct. 615)

☐ 8. (Repairs and Maintenance) – Please provide (1) a list showing the individual cost components of the total purchased repairs and maintenance expense and (2) invoices to support each cost component over $250 shown on the list. (Acct. 620)

☐ 9. (Outside Services) – Please provide (1) a list showing the individual cost components of the total purchased outside services expense and (2) invoices to support each cost component over $250 shown on the list. (Acct. 630)

☐ 10. Statements from the county for Property Tax expenses incurred during the Test Year. (Acct. 408.11)

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GENERAL INSTRUCTIONS

Processing the request for a rate adjustment requires completion of ALL PARTS of this application, including associated schedules. Specifically schedules 1-13 of the Excel file are required and should be printed out and submitted with the application. Schedules 14-19 are optional, as is using Items #4-9 in the format provided. Work papers 1, 3, 4, and 5 are required to be completed and to be made available to Staff as part of the rate case, but do not need to be printed out and filed with the application. Complete the Narrative Description of the Application for Rate Adjustment on pages 4 and 5, as well as the statements on pages 6 through 8. Read the accompanying instructions, download the associated excel file and fill out schedules 1 through 15 and any supplemental schedules and associated surcharge/adjustor mechanism included in the workbook. Dollar amounts should be rounded to the nearest dollar. NO ENTRY SHOULD BE LEFT BLANK. If an amount is zero, enter a zero. **Any application that is found to be insufficient will not be processed until the deficiencies are corrected per A.A.C. R14-2-103.B.7.**

A completed application also **requires** notification of customers of the rate request. The format of the customer notification letter is provided on page 15 of this application and also in the Excel file. Use the language and form of this letter in notifying customers. The customer notification **must** be provided to customers as soon as the application is found to be sufficient. A copy of this notice, together with a **notarized** cover letter stating the method of customer notification and the date the notification was sent to the customers, **must** be docketed as soon as completed.

Please provide any supplementary information the Company believes will assist in the evaluation of the rate request. For example, if expense items are substantially different from the latest annual report filed with the Commission, or if significant plant additions have been made since the prior rate increase, attach supporting explanations for those changes to the application. Clearly label any attachments and staple them to the application.

Selection of a Test Year for the utility is an important part of the application. A Test Year older than the year reflected in the most current Annual Report filed with the Utilities Division is usually considered outdated. Questions regarding the selection of a Test Year should be addressed to the Chief of Accounting and Rates at (602) 542-0743.

After you have included all the required items from the checklist on the previous page, please submit the **original and one additional copy** of the completed application with a cover sheet to:

Arizona Corporation Commission
Docket Control Center
1200 West Washington Street Phoenix,
Arizona 85007

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NARRATIVE DESCRIPTION OF APPLICATION FOR RATE ADJUSTMENT

Instructions:

Please provide the reasons for your requested rate adjustment by checking the appropriate box(es) below. If desired, the Company may also attach a written narrative regarding its reasons for the requested rate adjustment. Your narrative may also include efforts made by the utility to control costs/expenses and/or mitigate the amount of rate adjustment.

☐ Changes in current, compared to past operations that necessitate the rate adjustment Please explain:

_____

_____

_____

_____

☐ Descriptions and/or calculations of adjustments made to amounts that are included in this application that are different than amounts recorded in your books/ledgers (pro forma adjustments) Please explain:

_____

_____

_____

_____

☐ Significant factors influencing your revenues, expenses and/or rate base Please explain:

_____

_____

_____

_____

☐ Anticipated growth/decline in customers expected in the next two years, the amount of anticipated construction to serve those customers, and how financed; the type of customers served by the utility, e.g. residential, irrigation, small retail businesses, large commercial, etc. Please explain:

_____

_____

_____

_____

☐ Anticipated construction Please explain:

_____

_____

_____

_____

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☐ Efforts made to encourage conservation of water through the proposed rate design or through other means
Please explain:

_____
_____
_____
_____

☐ Other factors
Please explain:

_____
_____
_____
_____

Attach additional pages as necessary.

Company Name:	Test Year Ended:

AFFILIATE RELATIONSHIP

Please indicate a **yes** or **no** answer to the questions below and provide an explanation where necessary.

An affiliate relationship is one where an entity is directly or indirectly controlled by or controls another entity. This includes but is not limited to the power to direct the management policies of such entity, whether through ownership of voting securities, by contract, or otherwise. Does the Company have a relationship with another entity that may include corporations, partnerships, sole proprietorships, limited liability corporations (LLCs), as well as common ownership of a water company and another entity such as a development company or wastewater company?

Are any assets owned jointly with any affiliated or subsidiary entities?

☐ YES ☐ NO

If **Yes**, please provide a description of each jointly owned asset, its cost, and the percentage of the asset owned by the utility. (Please note the amounts reported on Schedules 3 through 5 should only include the percentage of plant owned by the utility.)

_____

_____

_____

_____

_____

Were any of the assets constructed or acquired from an affiliated or subsidiary entity?

☐ YES ☐ NO

If **Yes**, please identify the affiliated entity, the relationship with the utility, and a detailed listing of all transactions reflected in the Plant accounts. Also include detail for other balance sheet accounts, such as Advances, Contributions in Aid of Construction, inter-company payables and receivables, as well as affiliated revenues and expenses from the Company's Income Statement.

_____

_____

_____

_____

_____

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STATEMENTS IN SUPPORT OF RATE REQUEST

Complete the following statements in support of your rate request.

_____(the "Company") requests an adjustment in the existing rates charged by the Company. The information contained in this application is based upon a twelve-month Test Year ending_(mm/dd/yy). The Company had total operating revenues of $_____ , served_____metered and _____un-metered
(from Schedule 6 page 1)
customers, and **sold**_____gallons of water during the Test Year.
(from Schedule 7)

The Company is requesting a(n) increase/decrease in revenues in the amount of $_____.

Total annual operating revenues, if the Company is granted the rate adjustment, will be $_____.

The Company is current on all property taxes.	☐ YES	☐ NO
The Company is current on all sales taxes. (Please see checklist item 2 on page 1.)	☐ YES	☐ NO
The Company currently has a Curtailment Plan Tariff on file with the Commission	☐ YES	☐ NO
The Company currently has a Backflow Prevention Tariff on file with the Commission.	☐ YES	☐ NO

The Company notified its customers of its application for a rate adjustment on _____(mm/dd/yy). **A COPY OF THE NOTICE WITH A NOTARIZED COVER LETTER STATING THE METHOD OF CUSTOMER NOTIFICATION, AS WELL AS THE DATE OF THE NOTIFICATION, MUST BE ATTACHED. (See page 35)**

By completing this application in support of the Company's request for a rate adjustment, the Company realizes that Original Cost Less Depreciation ("OCLD") plant information will be used to determine the fair value rate base, i.e., the Company waives the right to Reconstruction Cost New.

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Check the box that corresponds with the utility's structure: Sole

- ☐ Proprietorship
- ☐ Partnership
- ☐ "C" Corporation
- ☐ "S" Corporation
- ☐ Limited Liability Company ("LLC")
- ☐ Association--Cooperative
- ☐ Other, please specify:_____

Note: If a corporation, please list stockholders and the respective number of shares owned below. Attach additional pages if needed.

Stockholders	Number of Shares Owned

I have read and completed this application, and to the best of my knowledge all of the information contained herein, and attached to this application, is true and correct.

Name of Authorized Representative (print):	Company Name:
Title:	Address:
Signature:	
Date:	Phone Number:
E-mail Address:	Fax Number:
Website Address:	

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CURRENT AND PROPOSED RATES AND CHARGES INSTRUCTIONS

Complete the cells highlighted in yellow on schedule 1 in the associated spreadsheet, showing rates and charges currently in effect, and those proposed by the Company. Specify the customer class or classes (i.e., residential, commercial, industrial, irrigation, all, or other classes) in the drop down boxes in column B. Please note that per Decision No. 75626[1], in order to provide clarity and consistency the Commission has issued policy guidelines where at least 50% of the total revenue requirement should be generated by the basic service charge and the first tier, and that no less than 10% and no more than 20% of the total revenue requirement should be generated by the third or highest tier.

MONTHLY CHARGE:

Enter the monthly minimum (or service) charge and gallons included in the minimum for each meter size. For example, enter "$12.00 for zero gallons." Propose a monthly minimum (or b a s i c service) charge for every meter size listed on page 9. Also, enter the commodity (or excess) charge for the gallonage the customer will be charged for gallons used over those included in the minimum charge. For example, enter "$1.25 per 1,000 gallons." If excess charges vary with gallonage used, enter the rates and gallons covered in each tier of consumption in the space provided. For example:

First Tier	Up to 3,000 gallons	$1.00 per 1,000 gallons
Second Tier	3,001 to 10,000 gallons	$1.50 per 1,000 gallons
Third Tier	Over 10,000 gallons	$2.50 per 1,000 gallons

If a flat rate, rather than a metered rate, is currently approved or proposed, enter the monthly rate in the space provided. A "flat rate" is a charge that is not based on gallons used. (For example, $10.00 for all the water you can use.) If the Company currently has a flat rate and wishes to continue this rate, please contact the Chief of Accounting and Rates at 602-542-0743. It is likely that Staff will **not** recommend the continuation of such a rate.

[1] Decision No. 75626 issued on July 25, 2016, page 13 lines 14-24.

Petitioner's Exhibit MD-2: Arizona Policy on Acquisition Adjustment Recovery

SERVICE CHARGES INSTRUCTIONS

Listed below are current and proposed service charges as appropriate. Commission Rules should be consulted in proposing new service charges. Please complete the information highlighted in yellow on Schedule 2 of the spreadsheet. List current and proposed rates, as well as any service charges not listed below that the Company proposes to charge.

Service Charge (Commission	Description
Service Line and Meter Installation Charge (R14-2-405.B)	A refundable Advance in Aid of Construction paid by a new customer to cover the cost of installing all customer piping up to the meter, as well as the cost of installing the meter. Propose a charge for every meter size listed on page11.
Establishment (R14-2-403.D.1)	A charge covering the cost to establish a new account for aperson requesting service when the utility needs only to install a meter for initial establishment, reestablishment, or reconnection.
After Hours Service Charge (R14-2-403.D.2)	A charge covering the cost of establishment, re-establishment and reconnection-delinquent after normal hours at the customer's requestor for the customer's convenience. After Hours Service Charge willbe in addition to the charge for any utility service provided.
Meter Test (R14-2-408.F)	A charge for testing the accuracy of a meter upon a customer'srequest. No charge will be levied if the meter is found to be in error by more than +/- three (3) percent.
Deposit (R14-2-403.B)	A refundable security deposit not exceeding two times the average residential class bill for residential customers, and not exceeding two and one-half times a non-residential customer's estimated maximum monthly bill.
Deposit Interest (R14-2-403.B.3)	Annual percentage interest rate applied to customer deposits. A six percent rate shall be applied if the company does not specify an interest rate with the Commission.
Re-establishment (R14-2-403.D.1)	A charge for service at the same location where the same customer had ordered a service disconnection within the preceding twelve-month period.
NSF Check (R14-2-409.F.1)	A fee for each instance where a customer tenders payment for utility service with an insufficient funds check.
Deferred Payment (R14-2-409.G.6)	Applicable monthly finance charges (interest rate) applied in adeferred payment agreement between the company and a customer.
Meter Re-read (R14-2-408.C.2)	Charge for a customer requested re-read of meter applicable when the original reading was found not to be in error.

UTILITY PLANT IN SERVICE INSTRUCTIONS

Instructions for Title sheet

To assist with the completion of Schedule 3 please refer to the Commission Decision issued in the Company's prior rate case. That Decision established the value for the Original Cost of the plant and accumulated depreciation at the end of the prior test year. It may be necessary to refer to the associated Staff Report for individual account detail relating to the totals listed in the Decision. Update the cells highlighted in grey in columns I and J with this information. Using the Company's records update column K for all fully depreciated plant.

Instructions for the Work papers

Please complete work papers 1, 3, 4, and 5. These work papers are not required to be printed off and filed with the application, but will be requested by Staff to assist with the audit of the rate case. On the work papers update all cells highlighted in grey. This includes the year(s) on work paper 1, which should begin with the year immediately following the test year in the last rate case through the test year in the current application, and the dollar amounts of all plant additions and retirements for each account by year.

Note: For assistance with any of the above, please contact the Chief of Accounting and Rates at 602- 542-0743.

INCOME TAX

The Commission allows federal and state income tax expense for taxable "type-C" corporations calculated by Staff at authorized tax rates. See Decision No. 73739.

For other entities such as Sole-Proprietorships, Partnerships, S-Corporations, Limited Liability Companies ("LLCs"), Trusts, and other taxable or pass-through entities the Commission has determined that an income tax allowance can be included in the utilities' expenses. The allowance will be based on the lower of the taxes computed using the Type-C corporate tax rates or the combined effective personal tax rates of the entities' owners.

In order for Staff to be able to calculate the effective personal tax rates of the entities' owners, the following information must be included in this application:

1. Names of all the owners.
2. The percentage of profit/(loss) assigned to each owner.
3. The owners' personal federal and state income tax filing status (i.e. single, married filing jointly, etc.).
4. If any of the owners are a pass-through or potential pass-through entity such as an S-Corporation or a Trust, then the ownership breakdown of the entity/trust will also be required including all the information listed above.

If the utility fails to provide all of the necessary information required, the Commission has determined that no income tax allowance will be recognized.

The following is an example of the calculations that Staff will make. For this situation, the Company is owned by a single person, registered as an LLC, whose income tax filing status is Married Filing Jointly. In this example, the Company has $50,000 in taxable income, and the calculations use 2015 tax brackets. As is shown in the results, per the Commission income tax policy the individual calculation would be used because it results in the lower total taxes,

Petitioner's Exhibit MD-2: Arizona Policy on Acquisition Adjustment Recovery

Income taxes based on individual calculations:

State Income Tax			Taxable Income	$50,000
Over	But not Over	Amount plus	%	Taxes
$0	$20,000	$0	2.59%	$0
$20,000	$50,000	$259	2.88%	$1,699
$50,000	$100,000	$691	3.36%	$0
$100,000	$300,000	$1,531	4.24%	$0
$300,000	$999,999,999	$5,771	4.54%	$0
				$1,699

Federal Income Tax			Taxable Income	$48,301
Over	But not Over	Amount plus	%	Taxes
$0	$18,450	$0	10.00%	$0
$18,450	$74,900	$1,845	15.00%	$6,323
$74,900	$151,200	$10,313	25.00%	$0
$151,200	$230,450	$29,388	28.00%	$0
$230,450	$411,500	$51,578	33.00%	$0
$411,500	$464,850	$111,324	35.00%	$0
$464,850	$9,999,999,999	$129,997	39.60%	$0
				$6,323

Calculation of corporate income tax:	
Arizona Taxable Income	$50,000
Arizona State Income Tax Rate	6.0000%
Arizona Income Tax	$3,000
Federal Taxable Income	47,000
Federal Tax on First Income Bracket ($1 - $50,000) @ 15%	7,050
Federal Tax on Second Income Bracket ($50,001 - $75,000) @ 25%	0
Federal Tax on Third Income Bracket ($75,001 - $100,000) @ 34%	0
Federal Tax on Fourth Income Bracket ($100,001 - $335,000) @ 39%	0
Federal Tax on Fifth Income Bracket ($335,001 -$10,000,000) @ 34%	0
Total Federal Income Tax	$7,050
Combined Federal and State Income Tax	$10,050

Petitioner's Exhibit MD-2: Arizona Policy on Acquisition Adjustment Recovery

BILL COUNT INSTRUCTIONS

Instructions for Schedule 6

A Bill Count must be provided for each of the meter sizes the Company had in service during the Test Year. This information will be entered on Schedule 6 from the drop-down boxes which are linked to Schedule 7, but ensure that the information is accurate and update as necessary on both schedules. Update the information in the grey highlighted cells with the counts at each level of usage for each meter. For all usage over 100,000 gallons enter the exact usage in rows 36 through 57. Hide any columns and/or rows that aren't needed.

The first step in producing the Bill Count is to collect all monthly bills rendered for metered water sales during the 12 months of the Test Year. The collection of bills must include bills to part-time customers and to customers who are no longer on the system, but who were on the system for any part of the Test Year.

Only include bills for water sold during the Test Year. For example, assume that the Test Year runs from January 1st to December 31st (calendar year) and you normally bill on January 5th. The bill sent out at that time would cover December 1st through the 31st usage of the prior year and should not be included. The first billing to be used for the year would be the February 5th billing and the last billing to be used would be the billing of January 5th of the succeeding year.

Note: For explanation of any of the above, please contact the Chief of Accounting and Rates at 602-542-0743.

Petitioner's Exhibit MD-2: Arizona Policy on Acquisition Adjustment Recovery

CUSTOMER NOTIFICATION

_____(Company Name) has applied to the Arizona Corporation Commission for an adjustment in rates. The current rates have been in effect since _____(mm/yy). A(n) increase/decrease in rates is necessary at this time due to _____ (reason for the Company's request for a rate adjustment as summarized from pages 3 and 4). Based on the Company's un-audited Test Year results, (Company Name) realized an operating income/loss of $_____. The Company is requesting a revenue increase/decrease of $_____or_____% of total revenues. Please see the attached Schedules 1 and 2 of the Company's application for the current and proposed rates.

The Application is available for inspection during regular business hours at the offices of the Commission in Phoenix at 1200 West Washington Street (for Tucson, call 800-535-0148 if located outside the Tucson local calling area or 520-628-6550 if inside the Tucson local calling area) and at *[name of Company and address]*. Please be advised that the rates and charges ultimately approved by the Commission may be higher or lower than the rates and charges requested in the Application.

Customer input is an important part of the Commission's analysis of the requested adjustment and is a factor in determining whether a hearing will be conducted. Customers should bring to the Commission's attention any questions or concerns related to the Company's Application, including service, billing procedures or other factors important in determining the reasonableness of charges. Customers may have the right to intervene in this matter. Customers wishing to communicate with the Commission, or request information on intervention in the proceeding, should contact the Commission's Consumer Services Section at 800-222-7000 (if locatedoutside the Phoenix local calling area) or 602-542-4251 in the Phoenix local calling area. Customers may also contact the Tucson Commission office by calling 800-535-0148 (if located outside the Tucson local calling area) or 520-628-6550 in the Tucson local calling area.

Customers are advised that the Commission may act upon the Application without a hearing. Regardless of whether a formal hearing is held, customer comments submitted in writing will be placed in the office file, which the Commission reviews prior to making its final decision on the Application. It is important that customers contact the Commission within 15 days of the receipt of this notice so that the Commission's Staff can consider customer comments and concerns in developing its recommendations to the Commission.

Decision No 75743

ATTACHMENT C

Small Water Utility ABC
Short Form Rate Application
WATER CONSERVATION ADJUSTMENT
Test Year Ended 12/31/2015

WATER CONSERVATION ADJUSTMENT

PERIOD	NUMBER OF CUSTOMERS	GALLONS SOLD (Thousands)	Average Kgal usage per Customer	Change in Usage Per customer
Test Year Ended 12/31/2015	2,000	47,166	23.58	(1.18)
2014	2,000	49,524	24.76	(1.24)
2013	2,000	52,001	26.00	(1.30)
2012	2,000	54,601	27.30	(1.37)
2011	2,000	57,331	28.67	

Average Decline in Use Per Customer	(1.27)
Percent Decline Expected	-5.39%

NOTE: If implementation of a rate increase will likely result in further decline than -0.0539, please enter the percentage you anticipate sales to decline below:

Anticipated Decline	-10.00%

Decline in Metered Water Revnues Expected	($16,818)	This Feeds to the Income Statement Automatically
Decline in Purchased Water Expense	($271)	
Decline in Purchased Power Expense	($3,088)	
Decline in Chemical Expense	($4,334)	

Explain Reason for Anticipated Decline

TYPE HERE

Instructions: Enter the amount of water sales in kgals and number of customers for the last 5 years from your annual reports.

Small Water Utility ABC
Short Form Rate Application
PURCHASED WATER ADJUSTOR MECHANISM (PWAM)
Test Year Ended 12/31/2015

PURCHASED WATER ADJUSTOR MECHANISM (PWAM)

As Part of this Rate Application, The Company is requesting approval of an adjustor Mechanism, whereby increased costs of Purchased Water may be recovered through a surcharge on customer bills. The Proposed calculation of such a charge is below:

Pass Through Calculation

Expected Purchased Water Expense	$3,720	
Expected Year Gallons Pumped (Thousands)	76,290	
Expected Year Water Expense per 1,000 Gal.	$0.05	
Test Year Purchased Water Expense	$2,976	From Schedule 8
Test Year Gallons Pumped (Thousands)	72,657	From Schedule 7
Test Year Water Expense per 1,000 Gal.	$0.04	
Expected Purchased Water Expense Normalized for Test Year Sales	$3,543	
Increase to Test Year Purchased Water Expense	567	
Water Sales During the Test Year	47,166	Annual Report Schedule 12
Expense Increase (Decrease) per Thousand Gallons Sold	$0.01	

PPAM Charge to Sample Customer Bill Monthly

5/8" Residential Usage	Gallons	Surcharge per Gallon
Average	552	$0.01
Gallons	5,000	$0.06
Gallons	10,000	$0.12
Gallons	15,000	$0.18

The Company Seeks to file, annually with the Commission, a calculation in this form, to support implementation of such a surcharge. **Calculations resulting in a credit will also be passed through to the customer.** Customer will be notified either by a message on their bill, by bill insert, or by mail.

Small Water Utility ABC
Short Form Rate Application
PURCHASED POWER ADJUSTOR MECHANISM (PPAM)
Test Year Ended 12/31/2015

PURCHASED POWER ADJUSTOR MECHANISM (PPAM)

As Part of this Rate Application, The Company is requesting approval of an adjustor Mechanism, whereby increased costs of Purchased Power may be recovered through a surcharge on customer bills. The Proposed calculation of such a charge is below:

Pass Through Calculation

Expected Purchased Power Expense	$42,465	
Expected Year Gallons Pumped (Thousands)	76,290	
Expected Year Power Expense per 1,000 Gal.	$0.56	
Test Year Purchased Power Expense	$33,972	From Schedule 8
Test Year Gallons Pumped (Thousands)	72,657	From Schedule 7
Test Year Water Expense per 1,000 Gal.	$0.47	
Expected Purchased Water Expense Normalized for Test	$40,443	
Increaes to Test Year Purchased Water Expense	6,471	
Water Sales During the Test Year	47,166	Annual Report Schedule 12
Expense Increase (Decrease) per Thousand Gallons Sold	$0.14	

PPAM Charge to Sample Customer Bill Monthly

5/8" Residential Usage	Gallons	Surcharge per Gallon
Average	552	$0.08
Gallons	5,000	$0.69
Gallons	10,000	$1.37
Gallons	15,000	$2.06

The Company Seeks to file, annually with the Commission, a calculation in this form, to support implementation of such a surcharge. **Calculations resulting in a credit will also be passed through to the customer.** Customer will be notified either by a message on their bill, by bill insert, or by mail.

Small Water Utility ABC
Short Form Rate Application
SYSTEM IMPROVEMENT FUND SURCHARGE (SIFS)
Test Year Ended 12/31/2015

SYSTEM IMPROVEMENT FUND SURCHARGE (SIFS)

As Part of this Rate Application, the Company is requesting approval of a System Improvemet Fund Surcharge, whereby vital capital expenditures made over the next 5 years may be recovered through a surcharge on customer bills. The proposed calculation of such a charge is below:

Number of equivalent meters from below	8,511	B
Charge for 5/8" customer per year	$0.99	A/B = C
Charge for 5/8" customer per month	$0.08	C / 12 = D

Table I

Meter Size	No. of Cust	Multiplier	Annual Equivalent Meters 5/8" x 3/4"	Annual Fixed Surcharge	Annual Annual Rev By Meter Size
	[1]	[2]	[3] = [1] * [2]	[4] = [Net SIFS Surcharge Table II] * 12	[5] = [1] * [4]
5/8" x 3/4" Meter	6,619	1.0 Time	6,619	$0.99	$6,558
3/4"Meter	108	1.5 Times	162	1.32	143
1" Meter	60	2.5 Times	150	2.28	137
1-1/2" Meter	48	5 Times	240	4.56	219
2" Meter	84	8 Times	672	7.32	615
3" Meter	23	16 Times	368	14.64	337
4" Meter	12	25 Times	300	22.80	274
6" Meter	0	50 Times	0	45.60	0
8" Meter	0	80 Times	0	72.96	0
10" Meter	0	115 Times	0	104.88	0
Totals	6,954	B	8,511		$8,282
			Probable Over/(Under) Collection Year 1		($151)

Table II

Meter Size	Multiplier	Monthly SIFS Surcharge *	Monthly SIFS Efficiency Credit	Monthly Net SIFS Surcharge	
5/8 X 3/4"	1.0 Time	$0.08	$0.00	$0.08	D
3/4"	1.5 Times	0.12	(0.01)	0.11	
1"	2.5 Times	0.20	(0.01)	0.19	
1.5"	5 Times	0.40	(0.02)	0.38	
2"	8 Times	0.64	(0.03)	0.61	
3"	16 Times	1.28	(0.06)	1.22	
4"	25 Times	2.00	(0.10)	1.90	
6"	50 Times	4.00	(0.20)	3.80	
8"	80 Times	6.40	(0.32)	6.08	
10"	115 Times	9.20	(0.46)	8.74	

* Surcharge has been rounded down to the nearest penny

Per Decision XXXXX		
ROR	7.00%	
ROE	10.00%	
Annual Depr Rate	NARUC	Description
3.33%	333	Services
2.00%	331	Valves
2.00%	335	Hydrants
8.33%	334	Meters
Conv Factor	1.64	

Total Authorized Revenues per Decision	$179,559
SIFS Revenue Cap %	5%
Annual SIFS Revenue Cap	$8,978
NET SIFS Rate Base	$63,750
Authorized Rate of Return	7.00%
Required Operating Income	$4,463
Conversion factor	1.64
Required Revenue	$7,319
Depreciation Expense	$1,480
SIFS Efficiency Credit	-5%
SIFS Revenue Requirement Efficiency Credit	($366)
Under Collection from Previous Year	$0
Proposed SIFS Authorized Revenue	$8,433

The Company seeks to file, annually with the Commission, a calculation in this form to support implementation of such a surcharge. Customer will be notified either by a message on their bill, by bill insert, or by mail.

*Note: This Figures Comes from Schedule 14 Page 10

Small Water Utility ABC
Short Form Rate Application
SYSTEM IMPROVEMENT FUND SURCHARGE (SIFS) CONTINUED
Test Year Ended 12/31/2015

SYSTEM IMPROVEMENT FUND SURCHARGE (SIFS) CONTINUED

As Part of this Rate Application, the Company is requesting approval of a System Improvemet Fund Surcharge, whereby vital capital expenditures made over the next 5 years may be recovered through a surcharge on customer bills. The proposed calculation of such a charge is below:

YEAR 1

Line No.		Services	Valves	Hydrants	Meters	Total
1	SIFS Eligible Investments	$50,000	$5,000	$5,000	$25,000	$85,000
2	Plant Retirements	(12,500)	(1,250)	(1,250)	(6,250)	(21,250)
3	Net Plant Line [1] + Line [2]	**$37,500**	**$3,750**	**$3,750**	**$18,750**	**$63,750**

ACCUMULATED DEPRECIATION

4

SIFS Eligible Investments Lines 13 to 16 Column [A]

5 Plant Retirements

6 Net Accumulated Depreciation [4] + Line [5]

7 Rate Base Line [3] + Line [6]

10 Depreciation Expense [Lines 13 to 16 Column C]

	Depreciation Expense by NARUC 1st Year	SIFS Investments	Plant Retirements	Net
13	Service Lines	$833	($208)	$624
14	Valves	50	(13)	38
15	Hydrants	50	(13)	38
16	Meters	1,041	(260)	781
17	Total	$1,974	($493)	$1,480

YEAR 2

Line No.		Services	Valves	Hydrants	Meters	Total
1	SIFS Eligible Investments	$50,000	$5,000	$5,000	$25,000	$85,000
2	Plant Retirements	(12,500)	(1,250)	(1,250)	(6,250)	(21,250)
3	Net Plant Line [1] + Line [2]	**$37,500**	**$3,750**	**$3,750**	**$18,750**	**$63,750**

ACCUMULATED DEPRECIATION

4 SIFS Eligible Investments Lines 13 to 16 Column [A]

5 Plant Retirements

6 Net Accumulated Depreciation [4] + Line [5]

7 Rate Base Line [3] + Line [6]

10 Depreciation Expense [Lines 13 to 16 Column C]

	Depreciation Expense by NARUC 1st Year	SIFS Investments	Plant Retirements	Net
13	Service Lines	$833	($208)	$624
14	Valves	50	(13)	38
15	Hydrants	50	(13)	38
16	Meters	1,041	(260)	781
17	Total	$1,974	($493)	$1,480

Small Water Utility ABC
Short Form Rate Application
SYSTEM IMPROVEMENT FUND SURCHARGE (SIFS) CONTINUED
Test Year Ended 12/31/2015

Schedule 18
Short Form Rate Application Page No. 26

SYSTEM IMPROVEMENT FUND SURCHARGE (SIFS) CONTINUED

As Part of this Rate Application, the Company is requesting approval of a System Improvemet Fund Surcharge, whereby vital capital expenditures made over the next 5 years may be recovered through a surcharge on customer bills. The proposed calculation of such a charge is below:

YEAR 3

Line No.		Services	Valves	Hydrants	Meters	Total
1	SIFS Eligible Investments	$50,000	$5,000	$5,000	$25,000	$85,000
2	Plant Retirements	(12,500)	(1,250)	(1,250)	(6,250)	(21,250)
3	Net Plant Line [1] + Line [2]	$37,500	$3,750	$3,750	$18,750	$63,750
	ACCUMULATED DEPRECIATION					
4						
	SIFS Eligible Investments Lines 13 to 16 Column [A]					
5	Plant Retirements					
6	Net Accumulated Depreciation [4] + Line [5]					
7	Rate Base Line [3] + Line [6]					
10	Depreciation Expense [Lines 13 to 16 Column C]					

	Depreciation Expense by NARUC 1st Year	SIFS Investments	Plant Retirements	Net
13	Service Lines	$833	($208)	$624
14	Valves	50	(13)	38
15	Hydrants	50	(13)	38
16	Meters	1,041	(260)	781
17	Total	$1,974	($493)	$1,480

YEAR 4

Line No.		Services	Valves	Hydrants	Meters	Total
1	SIFS Eligible Investments	$50,000	$5,000	$5,000	$25,000	$85,000
2	Plant Retirements	(12,500)	(1,250)	(1,250)	(6,250)	(21,250)
3	Net Plant Line [1] + Line [2]	$37,500	$3,750	$3,750	$18,750	$63,750
	ACCUMULATED DEPRECIATION					
4	SIFS Eligible Investments Lines 13 to 16 Column [A]					
5	Plant Retirements					
6	Net Accumulated Depreciation [4] + Line [5]					
7	Rate Base Line [3] + Line [6]					
10	Depreciation Expense [Lines 13 to 16 Column C]					

	Depreciation Expense by NARUC 1st Year	SIFS Investments	Plant Retirements	Net
13	Service Lines	$833	($208)	$624
14	Valves	50	(13)	38
15	Hydrants	50	(13)	38
16	Meters	1,041	(260)	781
17	Total	$1,974	($493)	$1,480

Small Water Utility ABC
Short Form Rate Application
SYSTEM IMPROVEMENT FUND SURCHARGE (SIFS) CONTINUED
Test Year Ended 12/31/2015

SYSTEM IMPROVEMENT FUND SURCHARGE (SIFS) CONTINUED

As Part of this Rate Application, the Company is requesting approval of a System Improvemet Fund Surcharge, whereby vital capital expenditures made over the next 5 years may be recovered through a surcharge on customer bills. The proposed calculation of such a charge is below:

YEAR 5

Line No.		Services	Valves	Hydrants	Meters	Total
1	SIFS Eligible Investments	$50,000	$5,000	$5,000	$25,000	$85,000
2	Plant Retirements	(12,500)	(1,250)	(1,250)	(6,250)	(21,250)
3	Net Plant Line [1] + Line [2]	**$37,500**	**$3,750**	**$3,750**	**$18,750**	**$63,750**

ACCUMULATED DEPRECIATION

4 SIFS Eligible Investments Lines 13 to 16 Column [A]
5 Plant Retirements
6 Net Accumulated Depreciation [4] + Line [5]
7 Rate Base Line [3] + Line [6]
10 Depreciation Expense [Lines 13 to 16 Column C]

	Depreciation Expense by NARUC 1st Year	SIFS Investments	Plant Retirements	Net
13	Service Lines	$833	($208)	$624
14	Valves	50	(13)	38
15	Hydrants	50	(13)	38
16	Meters	1,041	(260)	781
17	Total	$1,974	($493)	$1,480

TOTAL SIFS EXPENDITURES

Line No.		Services	Valves	Hydrants	Meters	Total
1	SIFS Eligible Investments	$250,000	$25,000	$25,000	$125,000	$425,000
2	Plant Retirements	(62,500)	(6,250)	(6,250)	(31,250)	(106,250)
3	Net Plant Line [1] + Line [2]	**$187,500**	**$18,750**	**$18,750**	**$93,750**	**$318,750**

ACCUMULATED DEPRECIATION

4 SIFS Eligible Investments Lines 13 to 16 Column [A]
5 Plant Retirements
6 Net Accumulated Depreciation [4] + Line [5]
7 Rate Base Line [3] + Line [6]
10 Depreciation Expense [Lines 13 to 16 Column C]

	Depreciation Expense by NARUC 1st Year	SIFS Investments	Plant Retirements	Net
13	Service Lines	$4,163	($1,041)	$3,122
14	Valves	250	(63)	188
15	Hydrants	250	(63)	188
16	Meters	5,206	(1,302)	3,905
17	Total	$9,869	($2,467)	$7,402

25-30.0371 Acquisition Adjustments.

(1) Definition. For the purpose of this rule, the following definitions apply:

(a) "Acquisition adjustment" means the difference between the purchase price of utility system assets to an acquiring utility and the net book value of the acquired utility's assets.

(b) "Good cause" means a showing of financial hardship, unforeseen events, or other events outside the utility's control.

(c) "Positive acquisition adjustment" means the purchase price is greater than the net book value.

(d) "Negative acquisition adjustment" means the purchase price is less than the net book value.

(e) "Non-viable utility" means a utility that meets either of the following subparagraphs:

1. A utility that is currently unable or is projected to be unable to provide and maintain safe, adequate, and reliable service and facilities to its customers over the 5-year period following the date of acquisition due to:

a. Failure to comply with or history of enforcement or compliance actions by federal, state, or local regulatory agencies based on violations of primary or exceedance of secondary water quality standards or other health, safety, and environmental standards; and

b. Insufficient investment, repair, maintenance of assets or an inability to acquire and maintain adequate managerial, operational, financial, or technical capabilities to ensure safe and reliable service to its customers; or 2. A utility that is insolvent, i.e., unable to pay debts.

(f) "Viable utility" means all utilities that are not non-viable as defined in paragraph (1)(e) of this rule.

(2) Petition. A utility that acquires another utility may petition the Commission to establish an acquisition adjustment under either subsection (3) or subsection (4) of this rule to include some or all of a positive acquisition adjustment in the acquired utility's rate base. A utility may seek approval of a positive acquisition adjustment at the time the utility seeks approval to transfer the certificate of authorization or anytime within 3 years of the issuance date of the Commission order approving the transfer of the certificate of authorization. The utility may request an extension of the 3-year period, which must include a statement of good cause. The petition for a positive acquisition adjustment may be made as a separate filing or as part of a rate proceeding.

(3) Positive Acquisition Adjustments for Non-Viable Utility.

(a) A full or partial positive acquisition adjustment will be allowed if it is demonstrated that the acquired utility meets the definition of non-viable utility under paragraph (1)(e) of this rule; that the purchase was made as part of an arms-length transaction; and that customers from the acquired utility will benefit from the acquisition. In determining whether the acquired utility customers benefit, the Commission will consider the following factors:

1. Anticipated improvements in quality of service;

2. Anticipated improvements in compliance with water or wastewater regulatory requirements;

3. Anticipated impacts on the cost of providing service over the next 5 years from the date of acquisition;

4. Anticipated cost efficiencies, including any economies of scale;

5. Ability to attract capital at reasonable cost; and

6. The professional and experienced managerial, financial, technical, and operational resources of the acquiring utility.

(b) Contents of Petition. The acquiring utility must file the following information in its petition:

1. The amount of the acquisition adjustment requested;

2. The amortization period requested;

3. An explanation of how the acquisition was made as part of an arms-length transaction;

4. The contract of sale, including the estimated cost of the fees and transaction closing costs to be incurred by the acquiring utility;

5. A calculation of the net book value of the acquired utility including the composite remaining life of the assets purchased;

6. A statement as to whether the acquired utility is insolvent or unable to service its debt obligations;

7. A description of the acquiring utility's managerial, operational, financial, or technical capabilities to furnish and maintain safe and adequate service and facilities over the next 5 years from the date of acquisition;

8. Any notices of violation, consent decrees or other regulatory actions issued by a federal, state, regional, or local agency regarding the provision of the acquired utility's water or wastewater service over the past 5 years from the date of acquisition, including any notices of violation of primary or notices of exceedances of secondary water quality standards;

9. The acquired utility's annual capital investments and operations and maintenance expenses over the past 5 years from the date of acquisition, if existing;

10. Any planned infrastructure additions and maintenance by the acquiring utility to improve the acquired utility's quality of service or compliance with environmental regulations;

11. Any engineering studies or appraisals the acquiring utility procured pertaining to the purchase of the acquired utility;

12. The 5-year projected impact on the cost of providing service to the customers of the utility system being acquired, including the impact of any operation and maintenance cost savings and economies of scale expected to result from the acquisition transaction, the impact of the cost of any plant infrastructure additions, and the impact of the acquisition adjustment; and

13. An explanation as to how the acquiring utility has greater access to capital than the acquired utility, if applicable.

(4) Positive Acquisition Adjustments for Viable Utility.

(a) A full or partial positive acquisition adjustment will be allowed if the acquiring utility demonstrates that the purchase was made as part of an arms-length transaction and the transaction incorporating the full or partial positive acquisition adjustment is projected to provide a positive cumulative present value of the revenue requirements (CPVRR) customer benefit over a 5-year period from the date of acquisition. If the CPVRR does not result in a positive customer benefit over the 5-year period, the Commission will consider the following factors in determining whether to allow a full or partial acquisition adjustment:

1. Anticipated improvements in quality of service and compliance with any regulatory requirements;

2. Anticipated rate reductions or rate stability over the next 5 years from the date of acquisition;

3. Anticipated cost savings;

4. Increased ability to attract capital at reasonable cost;

5. Lower overall cost of capital; and

6. Additional professional and experienced managerial, financial, technical, and operational resources.

(b) Contents of Petition. The acquiring utility must file the following information in its petition:

1. The amount of the acquisition adjustment requested;

2. The amortization period requested;

3. An explanation of how the acquisition was made as part of an arms-length transaction;

4. The contract of sale, including the estimated cost of fees and transaction closing costs to be incurred by the acquiring utility;

5. A calculation of the net book value of the acquired utility including the composite remaining life of the assets purchased;

6. A CPVRR in the form of a spreadsheet. Form PSC 1034 (3/24), entitled "Water and/or Wastewater Utilities Cumulative Present Value of the Revenue Requirements for Acquisition Adjustment Worksheet," which is incorporated by reference in this rule and is available at http://www.flrules.org/Gateway/reference.asp?No=Ref-16619, is an example CPVRR that may be completed and included in the acquiring utility's petition to comply with this subparagraph. The form may also be obtained from the Commission's website, www.floridapsc.com;

7. An Excel spreadsheet with the data and information included in the CPVRR analysis with the spreadsheet formulas intact;

8. All supporting data and assumptions used in the CPVRR spreadsheet;

9. A description of any anticipated improvements or planned infrastructure additions and maintenance by the acquiring utility;

10. A description, including any supporting data, of any anticipated cost savings resulting from the acquisition;

11. The 5-year projected rate impact on the customers of the utility system being acquired, including the rate impact of any cost efficiencies and economies of scale expected to result from the acquisition transaction, the rate impact of the cost of any plant infrastructure additions, and the rate impact of the acquisition adjustment; and

12. Any engineering studies or appraisals the acquiring utility procured pertaining to the purchase of the acquired utility.

(5) Amortization Period for a Positive Acquisition Adjustment. The Commission will set the amortization period in the order approving the positive acquisition adjustment. Amortization of the acquisition adjustment will begin on the date of issuance of the order approving the positive acquisition adjustment or on the date the sale closes, whichever occurs last.

(6) Nothing herein removes the Commission's existing authority to review a positive acquisition adjustment if the Commission finds that customer benefits did not materialize or subsequently changed within 5 years of the date of the order approving the positive acquisition adjustment.

(7) Negative Acquisition Adjustment. A negative acquisition adjustment will not be included in rate base.

(8) Notice. At the time the petition is filed with the Commission, the acquiring utility must provide a draft notice for review by Commission staff. Commission staff will review the draft notice within 7 days. Once staff has approved the notice, the acquiring utility must provide notice by regular mail to the Office of Public Counsel and by regular mail or personal service to each customer and owner of property located within the service area for both the acquiring utility and the utility being acquired, to the extent the

utilities' customers are within the Commission's jurisdiction. The notice required by this rule may be combined with the notice of Application for Authority to Transfer issued pursuant to Rule 25-30.030, F.A.C., or for existing customers, the notice may be included in their next bill. The notice must contain:

(a) Title: Notice of Utility's Petition to Establish an Acquisition Adjustment;

(b) A statement that the utility has filed a petition with the Commission to establish an acquisition adjustment for either a viable or a non-viable utility system;

(c) The date the petition was filed with the Commission;

(d) The docket number associated with the petition;

(e) A statement of the 5-year projected rate impact or the anticipated effect of the requested acquisition adjustment on rates for the next five years;

(f) A statement that the utility's petition is available on the Commission's website;

(g) The acquiring utility's address, telephone number, and business hours; and

(h) A statement that any customer substantially affected by the petition may file a motion to intervene in accordance with Rule 28-106.205, F.A.C.

Rulemaking Authority 350.127(2), 367.121(1)(f) FS. Law Implemented 367.071(5), 367.081(2)(a), 367.121(1)(a), (b) FS. History–New 8-4-02, Amended 11-22-10, 6-17-24.

16 Tex. Admin. Code § 24.41

Section 24.41 - Cost of Service

(a) Components of cost of service. Rates are based upon a utility's cost of rendering service. The two components of cost of service are allowable expenses and return on rate base.
(b) Allowable expenses. Only those expenses that are reasonable and necessary to provide service to the ratepayers may be included in allowable expenses. In computing a utility's allowable expenses, only the utility's test year expenses as adjusted for known and measurable changes will be considered. A change in rates must be based on a test year as defined in § RSA 24.3<subdiv>(37)</subdiv> of this title, relating to Definitions of Terms. Payments to affiliated interests for costs of service, or any property, right, or thing, or for interest expense are not allowed as an expense for cost of service except as provided in Texas Water Code (TWC) §13.185(e).

(1) Components of allowable expenses. Allowable expenses, to the extent they are reasonable and necessary, may include, but are not limited to, the following general categories:

(A) Operations and maintenance expense incurred in furnishing normal utility service and in maintaining utility plant used by and useful to the utility in providing such service.

(B) Depreciation expense based on original cost and computed on a straight-line basis over the useful life of the asset as approved by the commission.

(i) Depreciation expense is allowed on all currently used and useful depreciable utility property owned by the utility and depreciable utility plant, property and equipment retired by the utility, subject to the requirements of subparagraph (c)(2)(C) of this section. Depreciation expense is not allowed for property provided under explicit customer agreements or funded by customer contributions in aid of construction. Depreciation expense is allowed for all currently used and useful developer or governmental entity contributed property. A utility must calculate depreciation on a straight-line basis over the expected or remaining life of the asset, but is not required to use the remaining life method if salvage value is zero. A utility that does not use group depreciation and proposes to change the useful life of an asset with an accumulated depreciation balance must not change the accumulated depreciation balance and must adjust depreciation expense going forward based on the changed useful life.

(ii) The depreciation accrual for all assets must account for expected net salvage value in the calculation of the depreciation rate and actual net salvage value related to retired plant. The utility must submit sufficient evidence with the application establishing that the estimated salvage value, including removal costs, is reasonable. For a utility that uses group accounting, salvage value will be applied to the asset group in depreciation studies. For a utility that uses itemized accounting, salvage value will be applied to specific assets.

(C) Assessments and taxes other than income taxes.

(D) Federal income taxes on a normalized basis. Federal income taxes must be computed according to the provisions of TWC §13.185(f), if applicable.

(E) Funds expended in support of membership in professional or trade associations, provided such associations contribute toward the professionalism of their membership.

(F) Advertising, contributions and donations. The actual test year expenditures for advertising, contributions, and donations may be allowed as a cost of service provided that the total sum of all such items allowed in the cost of service must not exceed three-tenths of 1.0% (0.3%) of the gross receipts of the utility for services rendered to the public. The following expenses are the only expenses that may be included in the calculation of the three-tenths of 1.0% (0.3%) maximum:

(i) funds expended advertising methods of conserving water;

(ii) funds expended advertising methods by which the consumer can achieve a savings in total utility bills; and

(iii) funds expended advertising water quality protection.

(G) Credit card and electronic payment processing fees. Expenditures or fees charged by banks or companies for accepting and processing credit card, debit card or other forms of electronic payment from customers for water and sewer utility service may be allowed as a cost of service.

(2) Expenses not allowed. The following expenses are not allowed as a component of cost of service:

(A) legislative advocacy expenses, whether made directly or indirectly, including, but not limited to, legislative advocacy expenses included in professional or trade association dues;

(B) funds expended in support of political candidates;

(C) funds expended in support of any political movement;

(D) funds expended in promotion of political or religious causes;

(E) funds expended in support of or membership in social, recreational, fraternal, or religious clubs or organizations;

(F) funds promoting increased consumption of water;

(G) funds expended to mail any parcel or letter containing any of the items mentioned in subparagraphs (A) - (F) of this paragraph;

(H) interest expense of processing a refund or credit of sums collected in excess of the rate ordered by the commission;

(I) any expenditure found by the commission to be unreasonable, unnecessary, or not in the public interest, including, but not limited to, executive salaries, advertising expenses, rate case expenses, legal expenses, penalties and interest on overdue taxes, criminal penalties or fines, and civil penalties or fines; and

(J) the costs of purchasing groundwater from any source if:

(i) the source of the groundwater is located in a priority groundwater management area; and

(ii) a wholesale supply of surface water is available.

(c) Return on rate base. The return on rate base is the rate of return times rate base.

(1) Rate of return. The commission will allow each utility a reasonable opportunity to earn a reasonable rate of return, which is expressed as a percentage of invested capital, and will fix the rate of return in accordance with the following principles.

(A) The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.

(B) The commission will consider the utility's cost of capital, which is the composite of the cost of the various classes of capital used by the utility.

(i) Debt capital. The cost of debt capital is the actual cost of debt, plus adjustments for premiums, discounts, and refunding and issuance costs.

(ii) Equity capital. For companies with ownership expressed in terms of shares of stock, equity capital commonly consists of the following classes of stock.

(I) Common stock capital. The cost of common stock capital must be based upon a fair return on its value.

(II) Preferred stock capital. The cost of preferred stock capital is its annual dividend requirement, if any, plus an adjustment for premiums, discounts, and cost of issuance.

(C) The commission will consider the efforts and achievements of the utility in the conservation of resources, the quality of the utility's services, the efficiency of the utility's operations, and the quality of the utility's management, along with other relevant conditions and practices.

(D) The commission may consider inflation, deflation, the growth rate of the service area, and the need for the utility to attract new capital.

(2) Rate base. The rate of return is applied to the rate base. Assets retired before June 19, 2009, must be removed from rate base before the rate of return is applied to the rate base. Components to be included in determining the rate base are as follows:

(A) If a utility or its facilities were valued using the process for establishing fair market value in Texas Water Code (TWC) §13.305, the dollar value of the "ratemaking rate

base," as defined in TWC § 13.305(a)(2) and § 24.238(b)(4) of this title, relating to Fair Market Valuation, less accumulated depreciation.

(i) The installation date of the ratemaking rate base is the filing date of the commission's final order approving the acquisition of the ratemaking rate base in an application filed under TWC §13.301.

(ii) The ratemaking rate base will include an accrual for Allowance for Funds Used During Construction (AFUDC), as defined in § 24.238(b)(2) of this title, relating to Fair Market Valuation, for any post-acquisition improvements to the ratemaking rate base. The accrual will begin on the date the improvement cost was incurred and end on the earlier of:

(I) the fourth anniversary of the date the improvement was placed in service; or

(II) the filing date of the commission order in which the ratemaking rate base is first approved by the commission as part of the rate base set in a base rate proceeding.

(iii) For book and ratemaking purposes, depreciation on any post-acquisition improvement to the ratemaking rate base will be deferred and considered in the utility's next base rate proceeding.

(iv) Transaction and closing costs associated with the acquisition will be reviewed in the acquiring utility's first base rate proceeding after the transaction has been concluded.

(B) Original cost, less accumulated depreciation, of utility plant, property, and equipment used by and useful to the utility in providing service.

(C) Original cost, less net salvage and accumulated depreciation at the date of retirement, of depreciable utility plant, property and equipment retired by the utility.

(i) For original cost under this subparagraph or subparagraph (B) of this paragraph, the commission may adjust rate base and the rate of return on equity associated with the cost of plant and equipment that has been estimated by trending studies or other methods not based on or verified by historical records.

(ii) Original cost in this subparagraph or subparagraph (B) of this paragraph is the actual money cost, or the actual money value of any consideration paid other than money, of the property at the time it was dedicated to public use, whether by the utility that is the current owner or by a predecessor. Assets may be booked in itemized or group accounting, but all accounting for assets and their retirements must be supported by an approved accounting system.

(iii) On all assets retired from service, the original cost of an asset must be the book cost less net salvage value. If a utility calculates annual depreciation expense for an asset with allowance for salvage value, then it must account for the actual salvage amounts when the asset is actually retired. The utility must include the actual salvage calculation in its net plant calculation in the first full rate change application, excluding alternative rate method applications as described in § RSA 24.75 of this

title, relating to Alternative Rate Methods, it files after the date on which the asset was removed from service, even if it was not retired during the test year. Recovery of investment on assets retired from service before the estimated useful life or remaining life of the asset must be combined with over-accrual of depreciation expense for those assets retired after the estimated useful life or remaining life and the net amount must be amortized over a reasonable period of time taking into account prudent regulatory principles.

(iv) Accelerated depreciation is not allowed.

(v) For a utility that uses group accounting, all mortality characteristics, both life and net salvage, must be supported by an engineering or economic based depreciation study for which the test year for the depreciation is no more than five years old in comparison to the rate case test year. The engineering or economic based depreciation study must include:

(I) investment by homogenous category;

(II) expected level of gross salvage by category;

(III) expected cost of removal by category;

(IV) the accumulated provision for depreciation as appropriately reflected on the company's books by category;

(V) the average service life by category;

(VI) the remaining life by category;

(VII) the Iowa Dispersion Pattern by category; and

(VIII) a detailed narrative identifying the specific factors, data, criteria and assumptions that were employed to arrive at the specific mortality proposal for each homogenous group of property.

(vi) Reserve for depreciation under this subparagraph or subparagraph (B) of this paragraph is the accumulation of recognized allocations of original cost, representing recovery of initial investment, over the estimated useful life or remaining life of the asset. Depreciation must be computed on a straight-line basis over the expected useful life or remaining life of the item or facility regardless of whether the salvage value is zero or not zero.

(I) If individual accounting is used, the following requirements apply to retirements:

(-a-) Accumulated depreciation must be calculated based on book cost less net salvage value of the asset.

(-b-) The utility must provide evidence establishing the original cost of the asset, the cost of removal, salvage value, any other amounts recovered; the useful life of the asset, or remaining life as may be appropriate; the date the asset was taken out

of service; and the accumulated depreciation up to the date it was taken out of service.

(-c-) The utility must show that it used due diligence in recovering maximum salvage value of a retired asset.

(-d-) The utility must continue booking depreciation expense until the asset is actually retired, and the reserve for depreciation must include any additional depreciation expense accrued past the estimated useful or remaining life of the asset.

(-e-) The retirement of a plant asset from service is accounted for by crediting the book cost to the utility plant account in which it is included. Accumulated depreciation must also be debited with the original cost and the cost of removal and credited with the salvage value and any other amounts recovered.

(-f-) Retired assets must be specifically identified.

(-g-) The requirements relating to the accounting for the reasonableness of retirement decisions for individual assets and the net salvage value calculations for individual assets apply only to a utility using itemized accounting.

(II) For a utility that uses group accounting, the depreciation study must provide the information in subclause (I) except that retirements may be accounted for by category. Retired assets must be reported for the asset group in depreciation studies.

(III) TWC §13.185(e) applies to utility business transactions with affiliated interests involved in the retirement, removal, or recovery of assets.

(IV) For assets retired after June 19, 2009, the retired assets must be included in the utility's first application for a rate change after the date the asset was retired and must be specifically identified if the utility uses itemized accounting.

(vii) the original cost of plant, property, and equipment acquired from an affiliated interest may not be included in invested capital except as provided in TWC §13.185(e);

(viii) utility property funded by written customer agreements or customer contributions in aid of construction such as surcharges must not be included in original cost or invested capital.

(D) Working capital allowance to be composed of, but not limited to the following:
(i) reasonable inventories of materials and supplies held specifically for purposes of permitting efficient operation of the utility in providing normal utility service.

(ii) reasonable prepayments for operating expenses. Prepayments to affiliated interests are subject to the standards set forth in TWC §13.185(e); and

(iii) a reasonable allowance for cash working capital. The following will apply in determining the amount to be included in invested capital for cash working capital:

(I) Cash working capital for utilities must not exceed one-eighth of total annual operations and maintenance expense, excluding amounts charged to operations and maintenance expense for materials, supplies, fuel, and prepayments.

(II) For Class C and Class D utilities, one-eighth of operations and maintenance expense excluding amounts charged to operations and maintenance expense for materials, supplies, expenses recovered through a pass-through provision or through charges other than base rate and gallonage charges, and prepayments will be considered a reasonable allowance for cash working capital.

(III) For Class B utilities, one-twelfth of operations and maintenance expense excluding amounts charged to operations and maintenance expense for materials, supplies, expenses recovered through a pass-through provision or charges other than base rate and gallonage charges, and prepayments will be considered a reasonable allowance for cash working capital.

(IV) For Class A utilities, a reasonable allowance for cash working capital, including a request of zero, will be determined by the use of a lead-lag study. A lead-lag study will be performed in accordance with the following criteria:

(-a-) The lead-lag study will use the cash method. All non-cash items, including but not limited to depreciation, amortization, deferred taxes, prepaid items, and return, including interest on long-term debt and dividends on preferred stock, will not be considered.

(-b-) Any reasonable sampling method that is shown to be unbiased may be used in performing the lead-lag study.

(-c-) The check clear date, or the invoice due date, whichever is later, will be used in calculating the lead-lag days used in the study. In those cases where multiple due dates and payment terms are offered by vendors, the invoice due date is the date corresponding to the terms accepted by the utility.

(-d-) All funds received by the utility except electronic transfers will be considered available for use no later than the business day following the receipt of the funds in any repository of the utility, e.g., lockbox, post office box, branch office. All funds received by electronic transfer will be considered available the day of receipt.

(-e-) The balance of cash and working funds included in the working cash allowance calculation will consist of the average daily bank balance of all non-interest bearing demand deposits and working cash funds.

(-f-) The lead on federal income tax expense must be calculated by measurement of the interval between the mid-point of the annual service period and the actual payment date of the utility.

(-g-) If the cash working capital calculation results in a negative amount, the negative amount must be included in rate base.

(V) If cash working capital is required to be determined by the use of a lead-lag study under subclause (IV) of this clause and either the utility does not file a lead-lag study or the utility's lead-lag study is determined to be unreliable, in the absence of persuasive evidence that suggests a different amount of cash working capital, zero will be presumed to be the reasonable level of cash working capital.

(VI) A lead lag study completed within five years of the application for a rate or tariff change is adequate for determining cash working capital unless sufficient persuasive evidence suggests that the study is no longer valid.

(VII) Operations and maintenance expense does not include depreciation, other taxes, or federal income taxes, for purposes of subclauses (I), (II), (III) and (V) of this clause.

(3) Deduction of certain items from rate base. In the consideration of applications filed under TWC §13.187 or §13.1871, the commission will deduct certain items from rate base, including but not limited to the following:

(A) accumulated reserve for deferred federal income taxes;

(B) unamortized investment tax credit to the extent allowed by the Internal Revenue Code;

(C) contingency and property insurance reserves;

(D) contributions in aid of construction; and

(E) other sources of cost-free capital, as determined by the commission.

(4) Construction work in progress (CWIP). The inclusion of CWIP is an exceptional form of relief. Under ordinary circumstances, the rate base consists only of those items that are used and useful in providing service to the public. Under exceptional circumstances, the commission may include CWIP in rate base to the extent that the utility has proven that:

(A) the inclusion is necessary to the financial integrity of the utility; and

(B) major projects under construction have been efficiently and prudently planned and managed.

(5) Requirements for post-test year adjustments.

(A) A post-test year adjustment to test year data for known and measurable rate base additions may be considered only if:

(i) the addition represents a plant which would appropriately be recorded for investor-owned utilities in National Association of Regulatory Utility Commissioners (NARUC) account 101 or 102;

(ii) the addition comprises at least 10% of the utility's requested rate base, exclusive of post-test year adjustments and CWIP;

(iii) the addition is in service before the rate year begins; and

(iv) the attendant impacts on all aspects of a utility's operations, including but not limited to, revenue, expenses and invested capital, can with reasonable certainty be identified, quantified and matched. Attendant impacts are those that reasonably result as a consequence of the post-test year adjustment being proposed.

(B) Each post-test year plant adjustment described by subparagraph (A) of this paragraph will be included in rate base at the reasonable test year-end CWIP balance, if the addition is constructed by the utility, or the reasonable price, if the addition represents a purchase, subject to original cost requirements, as specified in TWC §13.185.

(C) Post-test year adjustments to historical test year data for known and measurable rate base decreases will be allowed only if:

(i) the decrease represents:

(I) plant which was appropriately recorded in NARUC account 101 or 102;

(II) plant held for future use;

(III) CWIP, not including mirror CWIP; or

(IV) an attendant impact of another post-test year adjustment.

(ii) the decrease represents a plant that has been removed from service, sold, or removed from the utility's books prior to the rate year; and

(iii) the attendant impacts on all aspects of a utility's operations, including but not limited to, revenue, expenses and invested capital, can with reasonable certainty be identified, quantified and matched. Attendant impacts are those that reasonably result as a consequence of the post-test year adjustment being proposed.

(d) Recovery of positive acquisition adjustments.

(1) When a utility acquires plant, property, or equipment for which commission approval is required under § RSA 24.239 of this title, relating to Sale, Transfer, Merger, Consolidation, Acquisition, Lease or Rental, a positive acquisition adjustment will be allowed to the extent that the acquiring utility proves that:

(A) the property is used and useful in providing retail water or sewer service at the time of the acquisition or as a result of the acquisition;

(B) reasonable, prudent, and timely investments will be made, if required, to bring the system into compliance with all applicable rules and regulations;

(C) as a result of the transaction:

(i) the customers of the system being acquired will receive higher quality or more reliable retail water or sewer service or that the acquisition was necessary so that customers of the acquiring utility's other systems could receive higher quality or more reliable retail water or sewer service;

(ii) regionalization of retail public utilities, meaning a pooling of financial, managerial, or technical resources that achieve economies of scale or efficiencies of service, was achieved; or

(iii) the acquiring utility will become financially stable and technically sound as a result of the acquisition, or the system being acquired that is not financially stable and technically sound will become a part of a financially stable and technically sound utility;

(D) any and all transactions between the buyer and the seller entered into as a part or condition of the acquisition are fully disclosed to the commission and were conducted at arm's length;

(E) the actual purchase price is reasonable in consideration of the condition of the plant, property, and equipment being acquired; the impact on customer rates if the acquisition adjustment is granted; the benefits to the customers; and the amount of contributions in aid of construction in the system being acquired; and

(F) the rates charged by the acquiring utility to its pre-acquisition customers will not increase unreasonably because of the acquisition.

(2) The owner of the acquired retail public utility and the final acquiring utility must not be affiliated. In a multi-stage transaction in which a purchase of voting stock or acquisition of controlling interest transaction under § RSA 24.243 of this chapter, relating to Purchase of Voting Stock or Acquisition of Controlling Interest in a Utility, is followed by a transfer of assets in what is essentially a single sales transaction, a positive acquisition adjustment is allowed only where the multi-stage transaction was fully disclosed to the commission in the application for approval of the initial stock or change of controlling interest transaction.

(3) The amount of the acquisition adjustment approved by the regulatory authority must be amortized using a straight-line method over a period equal to the weighted average remaining useful life of the acquired plant, property, and equipment, at an interest rate equal to the rate of return determined under subsection (c) of this section. The acquisition adjustment may be treated as a surcharge and may be recovered using non-system-wide rates.

(4) The authorization for and the amount of an acquisition adjustment will be determined only as a part of a rate change application.

(5) The acquisition adjustment will be included in rates only as a part of a rate change application.

(e) Negative acquisition adjustment. When a utility acquires plant, property, or equipment under § RSA 24.239 of this chapter, relating to Sale, Transfer, Merger, Consolidation, Acquisition, Lease or Rental, and the original cost of the acquired property less depreciation exceeds the actual purchase price, the utility must record the negative acquisition adjustment separately from the original cost of the acquired property. For purposes of ratemaking, the following will apply:

(1) If a utility acquires plant, property, or equipment from a nonfunctioning retail public utility through a sale, transfer, or merger, receivership, or the utility is acting as a temporary manager, a negative acquisition adjustment must be recorded and amortized on the utility's books with no effect on the utility's rates.

(2) If a utility acquires plant, property, or equipment from a retail public utility through a sale, transfer, or merger and paragraph (1) of this subsection does not apply, the commission may recognize the negative acquisition adjustment in the ratemaking proceeding, by ordering the amortization of the negative acquisition adjustment through a bill credit for a defined period of time or by other means determined appropriate by the commission. Except for good cause found by the commission, the negative acquisition adjustment will not be used to reduce the balance of invested capital.

(3) Notwithstanding paragraph (2) of this subsection, the acquiring utility may show cause as to why the commission should not account for the negative acquisition adjustment in the ratemaking proceeding.

(f) Subsections (d) and (e) of this section do not apply to plant, property, or equipment acquired through a transaction based on the fair market valuation process set forth in § 24.238 of this title, relating to Fair Market Valuation.

(g) Intangible assets will not be allowed in rate base unless the requirements in paragraphs (1), (2) and (3) of this subsection are met. If the requirements in paragraphs (1) and (2) of this subsection are met, but the requirement in paragraph (3) of this subsection is not met, the amount will be amortized over a reasonable period and the amortization will be allowed in the cost of service as a non-recurring expense. Unamortized amounts will not be included in rate base. The requirements are as follows:

(1) The amount requested has been verified by documentation as to amount and exact nature;

(2) Testimony establishes the reasonableness and necessity and benefit of the expense to the customers; and

(3) Testimony establishes how the amount is properly considered an actual asset purchased or installed, or a source of supply, such as water rights.

16 Tex. Admin. Code § 24.41

Former §24.41 adopted to be effective September 1, 2014, 39 TexReg 5903; Amended by Texas Register, Volume 40, Number 37, September 11, 2015, TexReg 6094, eff. 9/13/2015; Amended by Texas Register, Volume 41, Number 51, December 16, 2016, TexReg 9921, eff. 12/21/2016; Current section adopted by Texas Register, Volume 43, Number 41,

October 12, 2018, TexReg 6829, eff. 10/17/2018; Adopted by Texas Register, Volume 45, Number 33, August 14, 2020, TexReg 5637, eff. 8/20/2020

VERIFICATION

I, Mike Duncan, Vice President, verify, state, and affirm that I prepared or supervised the preparation of the Direct Testimony filed with this Verification, and that Direct Testimony is true and accurate to the best of my knowledge, information, and belief after a reasonable inquiry on this 12th day of July, 2024.

Mike Duncan
Vice President

STATE OF MISSOURI)
)
COUNTY OF ST. LOUIS)

SUBSCRIBED AND SWORN TO before me on this the 12th day of July, 2024.

Notary Public, State of Missouri
My Commission Expires 5/4